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IN THE

Supreme Court of the United States

TEXAS STATE BANK
(SUCCESSOR BY MERGER TO COMMUNITY BANK & TRUST),
Petitioner,

v.

UNITED STATES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), this Court held that interest earned on an asset of the clerk of a county court purchased with funds that had been deposited into the court registry was the property of the owners of the deposit, such that the county court's taking of the interest earned on such funds violated the Takings Clause of the Fifth Amendment to the Constitution. This case presents the following question:

Whether Petitioner has a cognizable property interest in the interest earned on assets of a Federal Reserve Bank purchased with Petitioner's noninterest-bearing deposits in the Reserve Bank, such that the transfer of such earnings to the U.S. Treasury rather than to Petitioner violates the Takings Clause of the Fifth Amendment to the Constitution.

PARTIES TO THE PROCEEDING

Petitioner in this case is Texas State Bank (successor by merger to Community Bank & Trust), the appellant below. Respondent in this case and the appellee below is the United States. The parent corporation of petitioner Texas State Bank is Texas Regional Bancshares, Inc., which is a publicly-traded corporation.

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Petitioner Texas State Bank respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The order of the court of appeals (App. 57a) denying the combined petition for rehearing and rehearing en banc is not reported. The opinion of the court of appeals (App. 1a) is reported at 423 F.3d 1370 (Fed. Cir. 2005). The order and opinion of the Court of Federal Claims dismissing Petitioner's complaint for lack of subject matter jurisdiction (App. 24a) is reported at 60 Fed. Cl. 815 (2004). The order and opinion of the Court of Federal Claims denying Re-

spondent's motion to dismiss and cross-motions for summary judgment (App. 38a) is reported at 54 Fed. Cl. 352 (2002).

JURISDICTION

The judgment of the court of appeals was entered on September 21, 2005. On December 13, 2005, the court of appeals denied Petitioner's petition for rehearing. The jurisdiction of the Court is invoked under 28 U.S.C. § 1254.

CONSTITUTIONAL PROVISIONS

The relevant provisions of the Fifth Amendment to the Constitution are set forth in Appendix E to this Petition. App. 58a.

STATEMENT OF THE CASE

Federal law requires Texas State Bank, along with all other depository institutions in the United States (hereinafter "banks"), to maintain reserves in the form of deposits in accounts at a Federal Reserve Bank or in Federal Reserve notes held on the banks' premises ("vault cash"). The Federal Reserve Banks pay banks no interest on the deposits or vault cash which they are required by law to maintain. The Federal Reserve Banks use the interest-free funds provided by banks to invest in interest-bearing assets, primarily U.S. Treasury and agency obligations. The net interest earned by the Federal Reserve on banks' reserves (after deduction of Federal Reserve expenses) is required by the Respondent to be transferred into the U.S. Treasury general fund. Petitioner seeks review of the U.S. Court of Appeals for the Federal Circuit's decision that Petitioner has no property interest cognizable under the Takings Clause of the Fifth Amendment in any portion of the net earnings derived from its reserves that are transferred by the Federal Reserve to the U.S. Treasury.

The Federal Circuit's sole basis for the divided panel's decision and Respondent's sole defense to this illegal taking is that the interest earned on the assets the Federal Reserve Banks purchase with the reserves that banks are required to maintain is the property of Respondent rather than property of the banks. In effect, Respondent claims that it can require any person, not just banks, to hold money with the government that pays no interest and then retain all earnings derived from the assets it acquired with the person's funds. Petitioner believes that this is in direct conflict with the Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), which affirmed the long-established rule that interest follows principal and is to be allocated to those who are the owners of the principal. This rule was reaffirmed by the Court in *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), and in *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003).

1. In establishing the Federal Reserve System, Congress authorized the Board of Governors of the Federal Reserve System (the "Board") to prescribe reserve requirements for banks "solely for the purpose of implementing monetary policy." 12 U.S.C. § 461(b)(2)(A) (2000). As required under federal law and regulation, all banks in the United States are subject to reserve requirements against their transaction (checking) accounts and nonpersonal time deposits. 12 U.S.C. § 461(b)(2)(A), (B), (D); 12 C.F.R. § 204.1(c)(1) (2006). In order to meet their reserve requirements, banks are required to maintain reserves in the form of noninterest-bearing deposits in accounts at the Federal Reserve Banks, in the form of Federal Reserve notes (vault cash), or a combination of both. 12 U.S.C. § 461(c); 12 C.F.R. § 204.3(b)(1). The Federal Reserve Banks do not pay interest on these reserves to the banks that maintain them, although they are not prohibited from doing so under the Federal Reserve Act. 12 U.S.C. §§ 341, 414. *See also*, Authority of the Board to Pay Interest on Required Reserves of Member Banks, Mem. to Bd.

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of Governors of the Fed. Reserve Sys. from the Legal Div. (June 19, 1978), App. 74a.

The Federal Reserve Banks use Petitioner's and other banks' reserves to fund their purchases of U.S. Treasury and agency securities, as well as to lend to banks pursuant to their statutory authority granted under the Federal Reserve Act, 12 U.S.C. §§ 221 *et seq.* The Reserve Banks earn interest on the securities and loans funded with Petitioner's reserves as well as reserves required to be maintained by other banks. Rather than paying to Petitioner and other banks the interest earned on the assets that the Reserve Banks purchase with reserves required to be maintained by Petitioner and other banks, the Federal Reserve pays the interest to the U.S. Treasury. *See* Income and Expenses of the Federal Reserve Banks, 1914-2004, tbl. 6, *91st Annual Rep. 2004*, Bd. of Governors of the Fed. Reserve Sys. The amount of the interest earned by the Federal Reserve Banks traceable to the deposits of banks can be easily determined. Tr. of Evidentiary Hr'g, *Comm. Bank & Trust v. United States*, No. 01-CV-571, Apr. 20, 2004 (Docket #101), Prof. George Benston, App. 66a-67a; Prof. Michael Woodford, App. 70a.

Until 1980, a bank that did not desire to maintain reserves against its deposits could avoid this requirement by choosing to be a "nonmember" bank, that is, a state bank that is not a member of the Federal Reserve System. 12 U.S.C. § 461(b) (1979); 12 C.F.R. Part 204 (1979). As an inducement to banks to be members of the Federal Reserve and maintain noninterest-bearing reserves, the Federal Reserve Banks provided payment and other services without charge. These services included free check collection, wire transfers, securities transfers and securities safekeeping. The provision of those services without charge served as compensation for the interest forgone by member banks on their noninterest-bearing reserves. *See, e.g.*, Authority of the Board to Pay

Interest on Required Reserves of Member Banks, Mem. to Bd. of Governors from the Legal Div. (June 19, 1978).

In response to the concerns expressed by the Board that the reduction in Federal Reserve membership and the commensurate reduction in required reserves adversely affected the Federal Reserve's ability to conduct monetary policy, Congress enacted the Monetary Control Act of 1980, Pub. L. No. 96-221, tit. 1, 94 Stat. 132 (the "MCA"), which imposed reserve requirements on all banks, including nonmember banks. The MCA also required the Federal Reserve to begin charging for its payment and other services at prices reflecting the costs of those services. 12 U.S.C. § 248a(a). These services became available on a fee basis to all banks, not just to member banks. 12 U.S.C. § 248a(c)(2). As a result, all banks have been required since 1980 to maintain noninterest-bearing reserves and have not received any form of compensation such as free payment and other Federal Reserve services.

Since 1947, as a result of direction by the U.S. Treasury, the Board has transferred the Reserve Banks' net earnings annually to the U.S. Treasury.[1] The Board accomplishes this by deeming the interest it has earned on all securities and loans in its portfolio, including those funded with Petitioner's reserves, as interest on Federal Reserve notes, under its au-

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[1] The original Federal Reserve Act of 1913 provided that all earnings of Reserve Banks, after payment of necessary expenses, dividends to member banks on their stock holdings and payments into a surplus fund, were to be paid to the United States as a franchise tax. Pub. L. No. 63-43 § 7, 38 Stat. 251 (1913). Congress eliminated this requirement in 1933. Banking Act of 1933, Pub. L. No. 73-66 § 4, 48 Stat. 163. Congress reinstated obligatory payments by the Reserve Banks to the U.S. Treasury in 1934 adding Section 13b to the Federal Reserve Act. Pub. L. No. 73-417 § 1, 48 Stat. 1105. Section 13b was repealed by Congress in 1958, ending any statutory requirement that Reserve Banks pay over earnings to the U.S. Treasury. Small Business Investment Act of 1958, Pub. L. No. 85-699 § 601, 72 Stat. 697.

thority to pay interest on Federal Reserve notes at a rate of interest determined by the Board. 12 U.S.C. § 414. Each year, the Board determines what interest rate the Reserve Banks will pay on Federal Reserve notes and the Reserve Banks pay such interest to the U.S. Treasury. While the Federal Reserve Act provides that the Reserve Banks shall pay such interest at a rate established by the Board, that section does not indicate to whom such interest shall be paid. *Id.*

In three years for which Petitioner seeks relief, 1997, 1998 and 2000, Congress specifically required the Federal Reserve to pay its earnings to the U.S. Treasury.[2] In 2005, the Federal Reserve transferred more than $21 billion to the U.S. Treasury, a portion of which represented earnings on assets purchased with reserves required to be maintained by banks. Press Release, Federal Reserve Board (Jan. 10, 2006).

2. Petitioner filed this action against the United States in the United States Court of Federal Claims on October 3, 2001, alleging that the nonpayment of interest on its required reserves by Respondent for the time period commencing with the enactment of the MCA in 1980 and continuing to the present day constitutes an unconstitutional taking violating Petitioner's rights under the Just Compensation Clause of the Fifth Amendment. Petitioner further alleged that Respondent

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[2] Notwithstanding the Federal Reserve's annual payment of its earnings to the U.S. Treasury, Congress mandated that for fiscal years 1997 and 1998 the Federal Reserve pay its net earnings to the U.S. Treasury. Omnibus Budget Reconciliation Act, Pub. L. No. 103-66 § 3002(a), 107 Stat. 312 (Aug. 19, 1993). In accordance with this statutory mandate, the Federal Reserve paid to the U.S. Treasury its net earnings on its portfolio for the period between September 1, 1996 and August 31, 1998. Federal Reserve Board, *91st Annual Rep. 2004*, tbl. 6. For fiscal year 2000, the Federal Reserve was ordered by Congress to transfer $3.752 billion for deposit in the General Fund of the U.S. Treasury. District of Columbia Appropriations Act, Pub. L. No. 106-113, App. E § 302, 113 Stat. 1501 (Nov. 29, 1999).

had illegally exacted the interest on required reserves, in violation of the Fifth Amendment Due Process Clause.

On November 8, 2002, the Court of Federal Claims issued an Order and Opinion denying Respondent's motion to dismiss and cross-motions for summary judgment. The court found that Petitioner had a property interest recognizable under the Fifth Amendment in the principal of its reserve accounts. App. 51a. The court also found that Petitioner's claim was limited to the statutory six years prior to the date of its complaint. App. 44a. However, the court subsequently stayed further proceedings in the case pending the outcome of *Brown v. Washington Legal Foundation*, 538 U.S. 216 (2003), in which the Court considered claims analogous to those asserted by Petitioner.

Following the Court's decision in *Brown*, the Court of Federal Claims conducted an evidentiary hearing on Petitioner's claims. On June 8, 2004, the Court of Federal Claims dismissed the case for lack of subject matter jurisdiction on the basis that Petitioner's action was in actuality directed to the Board, that the Board was a non-appropriated funds instrumentality ("NAFI"), and that the Court of Federal Claims lacks jurisdiction to grant a judgment against the United States on a claim against a NAFI because the United States has not assumed the financial obligations of such entity by appropriating funds. App. 34a, 36a. The Court of Federal Claims specifically stated, however, that it expressed no opinion as to whether the payment of the Federal Reserve's net earnings to the U.S. Treasury requires compensation under the Fifth Amendment. App. 34a.

On September 21, 2005, the United States Court of Appeals for the Federal Circuit concluded that the Court of Federal Claims had erred in dismissing the action for lack of jurisdiction pursuant to the NAFI doctrine. App. 3a. The Federal Circuit stated that the NAFI doctrine does not limit the scope of the Court of Federal Claims' jurisdiction over

claims against the United States based on the Takings Clause; the NAFI doctrine only barred non-constitutional claims, like those based on contract. The Federal Circuit further held that Petitioner's claim is based on actions by the United States and not the Board. App. 10a. The Federal Circuit stated that where, as in this case, "government command to a third party results in the transfer of alleged private property to the United States . . . the United States must bear responsibility if a direct government appropriation would itself constitute a compensable taking." App. 12a. The Federal Circuit thus held there was no jurisdictional bar to the takings claim against Respondent. App. 12a.

The Federal Circuit *sua sponte* went on to address the merits and held that Petitioner had no property interest pursuant to the Fifth Amendment in the earnings generated by the Federal Reserve's investment of its required reserves. App. 13a. The divided panel distinguished Petitioner's case from decisions of this Court holding that "interest follows principal," *Webb's*, 449 U.S. at 162; *Phillips*, 524 U.S. at 172; and *Brown*, 538 U.S. at 235, stating that in contrast to those cases "where the deposited funds were held by third party banks, here Texas State did not provide funds to a third party that were then deposited in an interest bearing account in a private bank, but entered into a direct depositor relationship with the Federal Reserve." App. 15a. Consequently, the court found the earnings on the reserves to be the property of the Federal Reserve Bank and not of Petitioner. The court stated that "[t]he mere fact that the Federal Reserve owed a debt to Texas State did not entitle Texas State to an imputed return on those funds or to a share of earnings of the Federal Reserve." App. 18a. As the divided panel found Petitioner had no property interest in the earnings on reserves, the court concluded there could be no illegal exaction or due process violation. App. 18a.

Judge Newman dissented in part from the majority's decision to *sua sponte* consider the merits, which were not the subject of the appeal. App. 19a. Judge Newman contended that the court should have applied this Court's holding that interest is the property of the owner of the principal, set forth in *Webb's*, *Phillips* and *Brown*, stating that indeed, "[l]aw and precedent leave no doubt that earnings on deposited money are the property of the depositor, not of the custodian and not of the state." App. 22a. Judge Newman cautioned that "[i]f this court is to create a unique exception for bank deposits with the Federal Reserve, more support is required than the panel majority theory that because the deposits are not labeled 'interest-bearing' and the earnings are placed in 'one big pot' in the Federal Reserve banks . . . the interest is not the property of the depositor." App. 22a (internal citation omitted).

The Federal Circuit subsequently denied Petitioner's petition for a panel rehearing and for hearing *en banc*. App. 57a.

REASONS FOR GRANTING THE WRIT

This case raises fundamental questions of law regarding the application of the Takings Clause of the Fifth Amendment as well as the interpretation of the Court's precedent by courts of appeal. The Court thus should grant review of the question presented.

First, the decision below conflicts with three decisions of this Court which establish that the owner of the principal has a property interest in the earnings on that principal and that the retention of income generated from that principal by the government, rather than the owner of the principal, constitutes a taking under the Fifth Amendment. This Court has consistently applied the "interest follows principal" doctrine to facts virtually indistinguishable from those of this case, namely, in *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980); *Phillips v. Washington Legal Foundation*,

524 U.S. 156 (1998); and *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003). The Federal Circuit's attempt to distinguish this Court's precedents on the basis that the deposited funds in *Webb's*, *Phillips*, and *Brown* were held by third-party private banks in interest-bearing accounts misapplies the Court's holding in those cases. Petitioner is required by federal law to maintain its reserves in a non-interest-bearing account at a Federal Reserve Bank. The Reserve Bank invests the funds Petitioner has provided and pays the interest earned to Respondent. Respondent cannot escape the reach of the Takings Clause simply because the Federal Reserve has mandated that it will pay no interest on the account into which Petitioner is required by law to place its funds. Grant of certiorari is necessary because the decision of the Federal Circuit is contrary to established precedents of this Court which have consistently affirmed the rule that interest follows principal.

Second, this case warrants review by the Court because its outcome will have a direct effect on the business of banking, the regulation of which is a matter of critical federal importance. The Federal Reserve itself has repeatedly stated that the expropriation by Respondent of interest earned on mandatory bank reserves constitutes a "tax" on the banking industry and inhibits the Federal Reserve's ability to conduct monetary policy. Letter from Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys. to Rep. Stephen L. Neal, Chairman, Subcomm. on Domestic Monetary Policy, House Comm. on Banking, Housing and Urban Affairs (Mar. 6, 1992) [hereinafter Letter to Stephen Neal]. The expectation of banks that the Federal Reserve will transfer interest earned on their reserves to the U.S. Treasury rather than to the banks that supplied the reserves leads to distorted economic consequences for the financial system as banks artificially reduce the level of reserves on transaction (checking) accounts and nonpersonal time deposits. Such behavior hinders the ability of the Federal Reserve to conduct mone-

tary policy through reserve requirements. *See, e.g., Hearing on Regulatory Relief Before the Sen. Comm. on Banking, Housing, and Urban Affairs,* 109th Cong. (2006) [hereinafter *Hearing on Regulatory Relief*] (statement of Donald L. Kohn, Member, Bd. of Governors of the Fed. Reserve Sys.); Letter from Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys. to Rep. Jack Metcalf (Sept. 26, 1997) [hereinafter Letter to Jack Metcalf].

I. THE FEDERAL CIRCUIT'S DECISION THAT PETITIONER HAS NO PROPERTY INTEREST IN ITS REQUIRED RESERVES CONFLICTS WITH THIS COURT'S PRECEDENTS

The divided panel of the Federal Circuit wrongly concluded that Petitioner did not have a property interest in the income generated through the use of its required reserves, and thus there could not be a taking under the Takings Clause. App. 18a.

The interest generated by the Federal Reserve's investment of Petitioner's required reserves is a property interest entitled to protection under the Fifth Amendment. This Court has stated that property is traditionally regarded as the "group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it." *United States v. General Motors*, 323 U.S. 373, 378 (1945). Petitioner has the right to possess, use and dispose of its required reserves. The reserves, although required by law to be maintained in either the form of deposits in accounts at Federal Reserve Banks or vault cash, remain the property of the Petitioner and may be withdrawn by the bank at any time. 12 U.S.C. § 464. Further, as to the interest earned on those reserves, *Webb's*, *Phillips* and *Brown* strongly support the conclusion that interest income generated by Petitioner's funds in mandated bank reserves constitutes Petitioner's property. The Court held in *Webb's*, 449 U.S. at 164, "earnings of a fund are

incidents of ownership of the fund itself and are property just as the fund itself is property." *See also, Phillips*, 524 U.S. at 168; *Brown*, 538 U.S. at 235. Texas law applies to define "property" in this case, which includes the interest earned on reserves. As the Court noted in *Phillips*, 524 U.S. at 166, and *Webb's*, 449 U.S. at 162, citing *Sellers v. Harris County*, 438 S.W.2d 242, 243 (Tex. 1972), Texas law recognizes that "interest follows principal" and does not recognize any traditional principles of property law that would lead one to conclude otherwise.

Moreover, the "lack of immediate right . . . does not automatically bar a claimant ultimately determined to be entitled to all or a share of the fund from claiming a proper share of the interest, the fruit of the fund's use, that is realized in the interim." *Webb's*, 449 U.S. at 162. Thus, the earnings of the Federal Reserve Banks transferred to the Respondent which are derived from Petitioner's reserves belong to Petitioner. "Regardless of whether the owner of the principal has a constitutionally cognizable interest in the *anticipated* generation of interest by his funds, any interest that *does* accrue attaches as a property right to the ownership of the underlying principal." *Phillips*, 524 U.S. at 168.

The Federal Circuit distinguished these precedents on the basis that Petitioner's reserve account at the Federal Reserve Bank was not a separate interest-bearing account at a third-party bank. App. 15a. The Federal Circuit's distinction is unjustified. In *Webb's*, the purchaser of Webb's pharmacies deposited the amount of its payment in the court registry in accordance with the Florida Bulk Transfers Act, pending distribution to Webb's creditors. Fla. Stat. § 676.106 (1977). The court ordered the court clerk to invest the purchaser's deposit of funds with the court in accordance with Florida law in interest-bearing certificates or U.S. government obligations. Florida law further provided that all interest accruing from the investments was to be deemed property of the court.

Webb's, 449 U.S. at 156. After deducting a statutorily prescribed fee,[3] the court clerk invested the proceeds in interest-bearing certificates and retained the interest earned on the investment of the proceeds. The Court stated that the deposited funds in *Webb's* were property held only for the ultimate benefit of Webb's creditors, not for the benefit of the court or the county. *Webb's*, 449 U.S. at 161. The purchaser's deposit of funds into the court registry bore no interest, just as Petitioner's deposit with the Federal Reserve Bank bears no interest. The court clerk in *Webb's* invested the funds owned by the multiple claimants and earned interest on such funds just as the Federal Reserve Bank invested Petitioner's funds, along with the funds of other banks, and earned interest on such funds. The court clerk in *Webb's* held funds for the benefit of creditors of Webb's and ultimately returned the proceeds to the creditors, just as the Federal Reserve holds deposits for the benefit of the banks, which can withdraw the deposits at any time. 12 U.S.C. § 464. The *Webb's* clerk was the owner of the investments it made with the claimants' funds just as the Federal Reserve is the owner of the assets it purchases with Petitioner's funds. The court clerk in *Webb's* paid the interest earned to the court. Here the Federal Reserve paid the interest earned to the U.S. Treasury. The facts in *Webb's* are virtually identical to those in this case.

In *Webb's* the Florida Supreme Court ruled that the interpleaded funds were public money and there was no unconstitutional taking as the interest earned on the clerk's investment was not private property. 374 So. 2d 951 (Fla. 1979). This Court reversed, holding that the "State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit

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[3] In Petitioner's case, all services provided to Petitioner by the Federal Reserve are separately charged for and paid by Petitioner and are not offset in any way by the Petitioner's required reserve balance.

in court." *Webb's*, 449 U.S. at 164. The funds could not be "recharacterized" as public money simply because they were held temporarily by the court in a form dictated by Florida law. *Id.* Likewise, Petitioner's reserves and the interest derived therefrom cannot be characterized as public money simply because federal law requires that they be held temporarily in the form of deposits in accounts at the Federal Reserve Banks or in Federal Reserve notes. The Court in *Webb's* applied the "usual and general rule" that interest follows principal, without any indication that the form in which the clerk maintained the interpleaded funds—in an interest-bearing account—was dispositive. *Id.* at 162-63. The Court reaffirmed its holding in *Webb's* in *Phillips*, 524 U.S. at 172, and *Brown*, 538 U.S. at 235, both of which involved commingled funds. This Court's holdings in *Webb's*, *Phillips* and *Brown* do not depend on whether the funds were maintained in a separate bank account or commingled with other funds. In this case, Petitioner's interest in commingled funds can be easily traced and its proportionate share of such funds remains its property. Tr. of Evidentiary Hr'g, *Comm. Bank & Trust*, Prof. George Benston, App. 66a-67a; Prof. Michael Woodford, App. 70a.

The Court in *Brown*, although finding that the petitioners had a property interest in the interest earned on funds held in IOLTA accounts, found there was no "net interest" to be distributed because the administrative expenses associated with determining and distributing the interest earned on client funds would exceed the amount of interest each client would receive. 538 U.S. at 237. Here, net interest is earned on Petitioner's reserves.

Respondent argues that unlike in *Webb's*, *Phillips* and *Brown*, here the assets on which interest is earned belong to the Federal Reserve Bank rather than to Petitioner and that Respondent retains the interest earned on its assets, not those of the Petitioner. This is pure sophistry. The Reserve Banks

invest the funds provided by banks to buy assets on which the Reserve Banks earn interest. These earnings are generated by assets funded entirely by the banks' property, and the interest earned on these assets is readily identifiable and can be easily allocated to the banks. Respondent's argument is equivalent to saying that Respondent can take funds of any citizen, commingle the funds, use them to buy assets, earn interest on those assets and avoid a taking by returning the funds, but not the interest earned thereon. Such a result is entirely opposite of the Court's holding in *Webb's, Phillips* and *Brown.*

Respondent further contends that a debtor-creditor relationship existed between Petitioner and the Federal Reserve Bank, and consequently, Petitioner's reserves held at the Federal Reserve Bank became the Reserve Bank's property. The Federal Circuit stated that "[u]nder normal principals [sic] of banking law, 'the relationship between a bank and its depositor is that of debtor and creditor.'" *See* App. 15a (quoting *Michie on Banks and Banking*, ch. IX § 1 (1994)). The court overlooked the very next sentence, which provides that this is the case "except under special circumstances or where there is a statute to the contrary. . . . However, a relationship other than that of debtor and creditor may be created by the nature of the deposit or the contract or the circumstances under which it is made." *Michie on Banks and Banking*, ch. IX § 1 (1994), App. 73a. Because Petitioner is required by federal law to maintain reserves with the Federal Reserve Bank, 12 U.S.C. § 461(c), the relationship between Petitioner and the Federal Reserve Bank is not the normal bank debtor-creditor relationship in which a depositor agrees to place funds with a bank in exchange for interest or services from the bank. *See* Tr. of Evidentiary Hr'g, *Comm. Bank & Trust*, Prof. George Benston, App. 67-69a; Prof. Michael Woodford, App. 70-72a. Petitioner is required to maintain reserves in an account at the Reserve Bank and is unable to negotiate the terms of the account. Further, the Federal Reserve Bank charges Petitioner separately for any services it

provides to Petitioner. 12 U.S.C § 248a(a). As the trial court acknowledged, the general rule "is not the necessary rule where the law abrogates this choice, mandating the deposit or the use to which any interest is put." App. 55a. Moreover, in *Webb's*, despite the fact that Florida law provided that the interest earned on the funds invested by the court clerk was deemed the property of the court, the Court had little problem determining that the interest belonged to Webb's creditors, who were the parties to whom the court owed the funds.[4]

For the reasons stated above, this Court's review is warranted as the decision below conflicts with the precedents of the Court on the application of the Takings Clause of the Fifth Amendment.

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[4] The two cases on which the Federal Circuit principally relies, *United States Shoe Corp. v. United States*, 296 F.3d 1378 (Fed. Cir. 2002) and *Leider v. United States*, 301 F.3d 1290 (Fed. Cir. 2002), do not support the Federal Circuit's decision. *United States Shoe* involved an exporter's demand for interest on the refund of a tax that had been found unconstitutional. The Federal Circuit held that the tax had become the property of the government when it was paid and therefore no interest was due to the exporter. *United States Shoe*, 296 F.3d at 1384. Here, there is no dispute that Petitioner's deposits with the Reserve Bank are the Petitioner's and may be withdrawn at any time. 12 U.S.C. § 464. Accordingly, unlike in *United States Shoe*, Petitioner does not give up incidents of ownership.

In Leider, a check issued by a bankruptcy court was not received by an unsecured creditor. The check was canceled and the funds were deposited with the U.S. Treasury. *Leider*, 301 F.3d at 1293. Two years later the creditor sought payment of his share of the estate and interest thereon. The Federal Circuit held that because interest was never earned on the funds, there was no interest to follow principal. *Id.* at 1296. In this case, interest was indeed generated by securities the Federal Reserve funded with Petitioner's reserves. *See Hearing Before the Subcomm. on Dom. and Int'l Monetary Policy of the House Comm. on Banking and Financial Services*, May 3, 1995, 81 *Fed. Reserve Bull.* 676 (July 1995) (statement of Edward W. Kelley, Jr., Member, Bd. of Governors of the Fed. Reserve Sys.); *91st Annual Rep. 2004*, tbl. 6.

II. REVIEW IS WARRANTED BECAUSE THE TAKING OF INTEREST EARNED ON REQUIRED BANK RESERVES PRESENTS AN ISSUE OF PARTICULAR FEDERAL IMPORTANCE

The Court's review is necessary as the outcome of this case holds tangible consequences for the business of banking, the regulation of which is an issue of singular federal importance. The government's expropriation of the interest earned on required reserves is in effect a "tax" on the banking industry, as recognized by the Board. Alan Greenspan, former Chairman of the Board, among others, has noted that the requirement for mandatory reserves, when coupled with the retention of earnings on reserves, constitutes a "tax" on the banking industry. Letter to Stephen Neal, *supra*. The "tax" results from the fact that the requirement to maintain reserves imposes a cost on banks in the amount of the interest forgone on those reserves. *See* Joshua N. Feinman, *Reserve Requirements: History, Current Practice, and Potential Reform*, 79 *Fed. Reserve Bull.* 569 (June 1993). These costs in turn are passed on to consumers, in the form of higher loan rates, lower deposit rates and higher costs of credit for borrowers. *Id.* at 570-71. Paying interest on reserves would "effectively eliminate much of the costs of reserve requirements without jeopardizing the stable demand for reserves that is needed for open market operations and for the smooth functioning of the reserves market." *Id.* at 569. Chairman Greenspan believes that the failure to pay interest on reserves is counterproductive to the very mandate for which required reserves exist—the implementation of monetary policy. Letter to Stephen Neal, *supra*. *See also*, Letter to Jack Metcalf, *supra*.

Due to the Federal Reserve's failure to pay interest to banks on their reserve balances, banks have in recent years implemented procedures such as sweep arrangements to artificially reduce the level of reserves they are required to maintain. *See Hearing on Regulatory Relief, supra*, (statement of

Donald L. Kohn, Member, Bd. of Governors of the Fed. Reserve Sys.); Letter from Alfonse M. D'Amato, Chairman, Sen. Comm. on Banking, Housing and Urban Affairs to the Hon. Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys. (Apr. 28, 1997).

The Federal Reserve has testified repeatedly before Congress that "paying interest on required reserve balances would remove a substantial portion of the incentive for depositories to engage in reserve avoidance measures, and the resulting improvements in efficiency should eventually be passed through to bank borrowers and depositors." *Hearing on Regulatory Relief, supra,* (statement of Donald L. Kohn, Member, Bd. of Governors of the Fed. Reserve Sys.). *See also, Hearing Before the Subcomm. on Fin. Instit. and Consumer Credit of the House Comm. on Fin. Services*, 107th Cong. (2001), 87 *Fed. Reserve Bull.* 301 (2001) (statement of Laurence H. Meyer, Member, Bd. of Governors of the Fed. Reserve Sys.).

In recent years Congress has considered legislation, which the Federal Reserve has supported, to expressly permit the Federal Reserve to pay interest to banks that maintain required reserves on the basis that it would assist in the implementation of monetary policy. *See, e.g., Hearing on Regulatory Relief, supra,* (statement of Donald L. Kohn, Member, Bd. of Governors of the Fed. Reserve Sys.); Letter from Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys. to Sen. Alfonse M. D'Amato, Chairman, Sen. Comm. on Banking, Housing and Urban Affairs (July 14, 1997); Letter to Jack Metcalf, *supra*; Letter to Stephen Neal, *supra.* In relation to bills introduced in Congress in 2000 and 2001 that would have expressly authorized the payment of interest on required reserves, Laurence H. Meyer, a Member of the Board and appearing on behalf of the Board, testified that the Board "strongly supports" such bills and had "commented favorably on such proposals on a number of previous occa-

sions over the years and the reasons for that position still hold today." *Hearing on H.R. 4209, Bank Reserves Modernization Act of 2000 Before the House Comm. on Banking and Fin. Services*, 106th Cong. 1-2 (2000). Members of Congress have in turn recognized that "the Fed would be better able to manage monetary policy because disincentives for holding funds at the Fed would be reduced. . . . [T]he sole purpose for reserves, as clearly stated in the Federal Reserve Act, is as a tool for the implementation of monetary policy." *Hearing on Payment of Interest on Sterile Reserves Before the House Comm. on Banking and Fin. Serv.*, 106th Cong. (2000) (statement of Rep. James A. Leach, Chairman, House Comm. on Banking and Fin. Services).

Although the Treasury Department did not believe the matter a high priority due to other more pressing budget issues, in 2000 the Treasury Department testified that "[a]s a matter of appropriate monetary control, paying interest on reserves might be a step in the right direction." *Hearing on H.R. 4209, the Bank Reserves Modernization Act of 2000, Before the House Comm. on Banking and Fin. Services*, 106th Cong. (2000) (statement of Gary Gensler, Under Sec'y, U.S. Dept. of Treasury). The Treasury Department has further testified that paying interest on reserve balances "might lead to greater economic efficiency" and "the decline in required reserve balances could potentially lead to greater short-term interest rate volatility . . . ." *Hearing Before the Subcomm. on Fin. Instit. and Consumer Credit of the House Comm. on Fin. Services*, 107th Cong. (2001) (statement of Donald V. Hammond, Acting Under Sec'y, U.S. Dept. of Treasury). *See also, Hearing on H.R. 758 and H.R. 859, Business Checking Freedom Act of 2003 Before the House Comm. on Banking and Fin. Services*, 108th Cong. (2003) (statement of Wayne Abernathy, Asst. Sec'y for Fin. Instit., U.S. Dept. of Treasury).

The Court's review is warranted to address this issue which directly affects the banking industry, the regulation of which is of great federal importance.

For the foregoing reasons, Petitioner believes that Petitioner has a cognizable interest in the interest earned in assets Federal Reserve Banks purchase with Petitioner's funds. This Court's precedents require Respondent to remit to Petitioner the interest earned on Petitioner's reserve balances which Respondent received from the Federal Reserve. Review by the Court is necessary to ensure that this issue, which is fundamental to the business of banking and the conduct of monetary policy, is rightly decided.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 10, 2006

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

04-5126

TEXAS STATE BANK
(successor by merger to COMMUNITY BANK & TRUST),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

Blake Henry Bailey, Bailey Law Firm, of Tyler, Texas, argued for plaintiff-appellant. With him on the brief was *J. Bennett White*, Wilson, Sheehy, Knowles, Robertson & Cornelius, P.C., of Tyler, Texas.

Kyle Chadwick, Trial Attorney, Commercial Litigation Branch, Civil Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With him on the brief were *Peter D. Keisler*, Assistant Attorney General, *David M. Cohen*, Director, and *Mary A. Melnick*, Assistant Director. Of counsel on the brief were *Richard M. Ashton*, Associate General Counsel, and *Katherine Wheatley*, Assistant General Counsel, Board of Governors of the Federal Reserve System, of Washington, DC.

Appealed from: United States Court of Federal Claims, Senior Judge Bohdan A. Futey

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

04-5126

TEXAS STATE BANK
(successor by merger to COMMUNITY BANK & TRUST),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

DECIDED: September 21, 2005

Before NEWMAN, SCHALL, and DYK, *Circuit Judges*.

Opinion for the court filed by *Circuit Judge* DYK. Opinion filed by *Circuit Judge* NEWMAN concurring in part, dissenting in part.

DYK, *Circuit Judge*.

Appellant Texas State Bank ("Texas State") is a state-chartered bank that holds (and has held) reserves in accordance with the requirements of the Monetary Control Act of 1980, Pub. L. 96-221, Title I, 94 Stat. 132. Texas State claims that a Fifth Amendment taking occurred when the United States allegedly directed the Federal Reserve Board to pay earnings generated by Texas State's mandated reserves to the United States Treasury ("Treasury").

The Court of Federal Claims dismissed for lack of jurisdiction, holding that Texas State's "action [was] directed against the activities of the Federal Reserve Board"; that the Federal Reserve Board was a non-appropriated funds instrumentality ("NAFI"); and that the NAFI doctrine precluded the

exercise of subject matter jurisdiction. *Tex. State Bank (successor by merger to Cmty. Bank & Trust) v. United States*, 60 Fed. Cl. 815, 819 (2004). We hold that the Court of Federal Claims had jurisdiction under the Tucker Act because Texas State's claim is based on actions by the United States and not the Federal Reserve Board. We conclude that the case must nonetheless be dismissed because Texas State has failed to assert a valid takings claim.

BACKGROUND

The Federal Reserve System was established in 1913 pursuant to the Federal Reserve Act ("FRA"). Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251, codified as amended at 12 U.S.C. §§ 221 *et seq.* (1913). A principal function of the Federal Reserve System has been to determine and implement monetary policy "so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." 12 U.S.C. § 225a. The System is composed of the Board of Governors of the Federal Reserve System and twelve regional Reserve banks ("the Federal Reserve"). Monetary policy is set by the Federal Open Market Committee and is implemented through open market operations, that is, the purchase and sale of government securities. Open market operations are funded with reserves supplied by participating banks, and these operations are profitable for the Federal Reserve. The Federal Reserve banks also provide check clearing and other banking services to financial institutions. *See generally* 12 U.S.C. §§ 221 *et seq.*

Before the passage of the Monetary Control Act of 1980, only national banks were required to join the Federal Reserve System and to maintain non-interest bearing, or "sterile" reserves with the Federal Reserve. State-chartered banks could elect to join, but their participation in the system was not mandatory. Member banks did not earn interest on reserves, but were entitled to several free services, including free check-clearing. When inflation rates rose in the late 1970's

and interest rates increased, voluntary participation of state-chartered banks in the Federal Reserve System declined as did the level of reserve deposits. *See generally* Joshua N. Feinman, *Reserve Requirements: History, Current Practice, and Potential Reform*, 79 Fed. Res. Bull. 569 (1993).

In 1980 Congress sought to reverse this trend through the passage of the Monetary Control Act, and required that all depositary institutions, i.e., all banks, hold sterile reserves, in the form of non-interest bearing deposits at the Federal Reserve Bank, or in the form of Federal Reserve notes (that is, currency) stored at the depository institution. The currency deposits are known as "vault cash." *Id.*; 12 U.S.C. § 461(c). The Federal Reserve has consistently, but unsuccessfully, urged Congress to allow for the payment of a market-rate of interest on required reserves.[1] On the other hand, the Treasury has opposed what it views as "the use of taxpayer resources for this purpose."[2]

The parties have stipulated that the Federal Reserve's open market operations, funded by required reserves, generate substantial income. The parties have also stipulated that the

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[1] The Federal Reserve has taken the position that "[n]oninterest-bearing reserve requirements represent a tax on depository institutions that is not borne by other suppliers of financial services [and which] impairs the efficiency of resource allocation. . . . Paying such interest would circumvent the ill-effects of reserve requirements while preserving their advantages for monetary policy. . . . [R]eserve requirements provide for a reasonably predictable demand for overall reserve balances [which] is essential for the effective implementation of open market operations." Letter from Alan Greenspan, Chairman, Board of Governors of Federal Reserve System, to Rep. Stephen Neal, Chairman, Subcommittee on Domestic Monetary Policy of House Committee on Banking, Finance, and Urban Affairs (March 6, 1992).

[2] Testimony of Treasury Acting Under Secretary Donald V. Hammond before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, U.S. House of Representatives, March 13, 2001.

"Federal Reserve notes held as mandatory reserves in the form of vault cash result in earnings for Federal Reserve Banks in the same manner the maintenance of reserve balances in the accounts at the Federal Reserve Banks generate [sic] income for the Federal Reserve Banks." Pl. Contentions Together with Defendant's Responses at ¶ B5. The income generated by the sterile deposits and vault cash is used to pay the expenses of the Federal Reserve, and the remainder is transferred by the Federal Reserve Banks to the Treasury on a yearly basis. This transfer occurs each year by direction of Treasury. In fiscal years 1997, 1998, and 2000, the transfer was statutorily mandated. Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66 § 3002(a), 107 Stat. 312; Appendix to District of Columbia Appropriations Act, Pub. L. 106-113, § 302, 113 Stat. 1501 (Nov. 29, 1999).

Texas State has maintained sterile reserves and vault cash in accordance with the Monetary Control Act since 1980. *Cmty. Bank & Trust v. United States*, 54 Fed. Cl. 352, 354 (2002).[3] In October 2001, Texas State brought suit against the United States in the Court of Federal Claims, alleging jurisdiction under the Tucker Act, 28 U.S.C. § 1491(a)(1). Texas State did not challenge the statutory requirement to maintain reserves pursuant to the Monetary Control Act, nor allege that such a requirement constituted a taking.[4] Rather, in its complaint, Texas State asserted that "[i]ncome on the principal is the property of the owner of the principal. As such, the income on deposits and vault cash belong [sic] to the depository institutions that have maintained required reserves." Complaint at ¶ 28. Texas State alleged that the United States had

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[3] Texas State is the successor by merger to Community Bank and Trust, the party which made the deposits in earlier years.

[4] Under our decision in *Commonwealth Edison Co. v. United States*, the "mere imposition of an obligation to pay money . . . does not give rise to a claim under the Takings Clause of the Fifth Amendment." 271 F.3d 1327, 1340 (Fed. Cir. 2001) (en banc).

engaged in a Fifth Amendment taking by directing the Federal Reserve to transfer the "earnings on required reserves maintained by depository institutions" to the Treasury. *Id.* at ¶¶ 28-31. The complaint also alleged, in the alternative, a violation of due process or an illegal exaction. *Id.* at ¶¶ 30-31. Texas State sought money damages equal to the earnings plus interest. *Id.* at ¶ 32. It also sought certification of a class of similarly situated depositary institutions that since 1980 maintained required reserves in accordance with the Monetary Control Act. *Id.* at ¶¶ 20, 22.

The government moved to dismiss, arguing that jurisdiction was precluded because the Federal Reserve was a non-appropriated funds instrumentality ("NAFI"), and the NAFI doctrine barred suit. *Cmty. Bank & Trust*, 54 Fed. Cl. at 355-59.[5] The NAFI doctrine is "an established exception to the Tucker Act . . . based on the premise that the government has never waived its sovereign immunity to allow private parties to bring breach of contract claims against NAFIs." *AINS, Inc. v. United States*, 365 F.3d 1333, 1336 (Fed. Cir. 2004). In response, Texas State pointed out that this case involves a takings claim rather than an effort to recover on a government contract. Texas State also argued that it was the actions of Congress and Treasury that were the cause of the alleged taking, not those of the Federal Reserve, and that the NAFI doctrine did not apply. *Cmty. Bank & Trust*, 54 Fed. Cl. at 356. In the alternative, the government moved to dismiss for failure to state a claim, and Texas State moved for partial summary judgment with respect to liability on its takings claim, contending that in light of the "interest follows

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[5] The government also argued that the claim was time-barred by the Tucker Act's six-year statute of limitations, 28 U.S.C. § 2501. The Court of Federal Claims disagreed, holding that Texas State's cause of action—as limited to the damages claimed for the statutory six years prior to the date of the complaint—had accrued within the limitations period. *Cmty. Bank & Trust*, 54 Fed. Cl. at 355-56, 361.

principal" holdings of the Supreme Court's decisions in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), and *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), the "payment of interest on its principal to the Treasury [was] a taking as a matter of law." 54 Fed. Cl. at 360.

In an initial opinion, the court declined to dismiss for lack of jurisdiction under the NAFI doctrine, and "reserve[d] judgment on the relevance and consequence of the Board of Governors' NAFI status until additional facts [became] available." *Id.* at 356. With respect to the merits of the takings claim, the court denied the government's motion to dismiss for failure to state a claim, and held that "[f]or the limited purpose of this motion to dismiss, the court finds that plaintiff has a property interest in the principal of its reserve accounts, cognizable under the Fifth Amendment." *Id.* at 359. However, the court noted that it was not "clear, for instance, that plaintiff's funds are placed in the type of separate, interest bearing . . . account at issue in" potentially analogous cases. *Id.* The court also denied the plaintiff's partial summary judgment motion. The case was then stayed, pending the outcome of the Supreme Court's decision in *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003), where certiorari had been granted to determine whether or not a taking occurred when the State of Washington required that interest earned on IOLTA accounts be paid to government-designated organizations providing legal services to the poor.

The Supreme Court decided *Brown* in March 2003, holding that transfer of interest earned in IOLTA accounts to pay for legal services for the poor constituted a *per se* taking, but that no compensation was due because there was no net loss to the clients who owned the principal. *Id.* at 235-37. In June 2004, after further briefing and an evidentiary hearing on the merits, the Court of Federal Claims dismissed this action for lack of

jurisdiction without reaching the merits. *Tex. State*, 60 Fed. Cl. at 821. The court held that the Federal Reserve was a NAFI and that the NAFI doctrine barred jurisdiction over takings claims against the United States based on actions taken by NAFIs. The court rejected Texas State's argument that the United States was the responsible party, finding that "[a]t bottom . . . its action is directed against the activities of the Federal Reserve." *Id.* at 819.

Texas State timely appealed. We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3). *Folden v. United States*, 379 F.3d 1344, 1354 (Fed. Cir. 2004). Following oral argument, we ordered the parties to submit supplemental briefing addressing the question "[w]hether Texas State Bank had a cognizable property interest in any portion of the net earnings of the Federal Reserve Board during the years in question."

DISCUSSION

I

A decision of the Court of Federal Claims "to dismiss a complaint for lack of jurisdiction is a question of law subject to . . . independent review by this court." *Shearin v. United States*, 992 F.2d 1195, 1195 (Fed. Cir. 1993); *see also AINS*, 365 F.3d at 1336; *Core Concepts of Fl., Inc. v. United States*, 327 F.3d 1331, 1334 (Fed. Cir. 2003). We conclude that the Court of Federal Claims erred in dismissing the action for lack of jurisdiction pursuant to the NAFI doctrine.

We recently had occasion to review the NAFI doctrine in the takings context in *Lion Raisins, Inc. v. United States*, 416 F.3d 1356, 1365-66 (Fed. Cir. 2005). The doctrine has its origins in the Supreme Court's decision in *Standard Oil Co. v. Johnson*, 316 U.S. 481, 485 (1942), where the Court, in ruling that Army "post-exchanges" qualified for a federal government exemption from a California state tax, found that the "post exchanges as now operated are arms of the Government" but that the "Government assumes none of the

obligations of the exchanges." *Id.* Since *Standard Oil*, we have repeatedly held that the NAFI doctrine precludes the exercise of Tucker Act jurisdiction over contract claims against the United States based upon the contracting activities of NAFIs that are not expressly mentioned in 28 U.S.C. § 1491(a)(1).[6] *See Lion Raisins*, 416 F.3d at 1365-66 (collecting cases of this court and of our predecessor, the Court of Claims). These cases have applied "[t]he general rule . . . that the Court of Federal Claims lacks jurisdiction to grant judgment against the United States on a claim against a NAFI because the United States has not assumed the financial obligations of those entities by appropriating funds to them." *El-Sheikh v. United States*, 177 F.3d 1321, 1324 (Fed. Cir. 1999) (quotation marks and citations omitted); *see also United States v. Hopkins*, 427 U.S. 123, 127 (1976).

The United States asserts that, under our precedent, the Federal Reserve Board is a NAFI. *See AINS*, 365 F.3d at 1340; *Denkler v. United States*, 782 F.2d 1003, 1004-05 (Fed. Cir. 1986); *accord Research Triangle Inst. v. Bd. of Gov. of the Fed. Res. Sys.*, 132 F.3d 985 (4th Cir. 1997). The government further urges that the NAFI jurisdictional bar be extended beyond contract claims, to encompass takings claims against the United States based on actions by a NAFI. This argument was recently rejected in *Lion Raisins*, where we concluded that the United States may properly be sued in the Court of Federal Claims for any takings that are allegedly

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[6] In 1970, Congress amended the Tucker Act to allow jurisdiction over contract claims against the armed forces exchanges, adding the following sentence to 28 U.S.C. § 1491(a)(1): "For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States." *See generally McDonald's Corp. v. United States*, 926 F.2d 1126, 1129-31 (Fed. Cir. 1991) (discussing the 1970 amendments and their legislative history).

consummated by NAFIs acting as its agents, finding "no basis in the text of the Tucker Act itself; the legislative history of the 1970 amendments; or in the decisions of the Supreme Court or this court, for limiting the scope of the jurisdictional grant over claims 'against the United States . . . founded upon the Constitution' to exclude takings claims against the United States based on actions by NAFIs." *Lion Raisins*, 416 F.3d at 1367-68. Here, however, we do not reach the question of whether the actions of the Federal Reserve can impose takings liability on the United States. We hold that, contrary to the decision of the Court of Federal Claims, it is the actions of the United States, and not those of the Federal Reserve, which are alleged to give rise to the takings claim.

II

As originally stated in its complaint, confirmed in its filings before the Court of Federal Claims, and reiterated before this court during oral argument, the only action being challenged by Texas State is the compulsion by Congress or the Treasury that the Federal Reserve transfer to the Treasury its net earnings, earnings which were based in part on income from open market operations funded by required reserves. Indeed, Texas State contends that these transfers were effected over the objections of the Federal Reserve, and that the United States "compels the Federal Reserve to send earnings on required reserves to the Treasury rather than pay such earnings to depository institutions that maintain required reserves." Pl. Contentions Together with Defendant's Responses at ¶ I.7. Texas State argues that these earnings were its property, and that by directing the Federal Reserve to transfer its property to the Treasury, the United States accomplished a Fifth Amendment taking.

Here, it is alleged that the United States was responsible for directing the transfer of earnings to the Treasury, and the

Federal Reserve had no discretion but to comply.[7] When the action that constitutes the taking is compelled by government, then the government can be held liable for the taking. For example, in *International Paper Co. v. United States*, 282 U.S. 399 (1931), the Supreme Court found the United States liable for a taking when the Secretary of War ordered a private power company to divert water from the owners of water-rights to increase power production for government uses. In that case, the requisition order covered "all of the water capable of being diverted" and was "intended to cut off the water being taken by the International Paper Company [pursuant to their lease with the power company] and thereby increase [the power company's] productive capacity." *Id.* at 405-06. The Court found that "it [was] hard to see what more the Government could do to take the use" when the requisition order directed the power company to withdraw water from the petitioner's mill and turn it elsewhere, to produce power for the benefit of the government. *Id.* at 407.

Our decisions also have recognized that a Fifth Amendment taking may occur when the government commands actions by a third party that would constitute a taking if undertaken directly by the government. *See, e.g., Hendler v. United States*, 952 F.2d 1364 (Fed. Cir. 1991); *Turney v. United States*, 126 Ct. Cl. 202, 115 F.Supp. 457 (1953); *see also Aerolineas Argentinas v. United States*, 77 F.3d 1564 (Fed. Cir. 1996). "[A] compensable taking does not occur unless the government's actions on the intermediate third party have a 'direct and substantial' impact on the plaintiff asserting the takings claim." *Casa de Cambio Comdiv S.A., de C.V. v. United States*, 291 F.3d 1356, 1361 (Fed. Cir.

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[7] While the calculation of net earnings "depends on the expenses of the Federal Reserve, which are largely discretionary," 60 Fed. Cl. at 819, the Federal Reserve exercises no discretion with respect to the action alleged to constitute the taking--the transfer of earnings generated by use of Texas State's reserves to the Treasury.

2002). At the same time, we have held that there is no potential taking when the government is alleged to have had only mere awareness of the actions of the third party, *see, e.g., Shewfelt v. United States*, 104 F.3d 1333, 1337 (Fed. Cir. 1997); or the government is alleged to have only engaged in "friendly persuasion" with respect to that activity, *see, e.g., Langenegger v. United States*, 756 F.2d 1565, 1572 (Fed. Cir. 1985); or the third party has exercised its own discretion, *see, e.g., Erosion Victims of Lake Superior Regulation v. United States*, 833 F.2d 297, 300-01 (Fed. Cir. 1987).

To be sure, not every requirement by the United States that a third party take action that adversely affects the economic interests of another entity implicates the Takings Clause, or requires that the private party actions be treated as equivalent to government action. But where, as here, the government command to a third party results in the transfer of alleged private property to the United States, we think that the United States must bear responsibility if a direct government appropriation would itself constitute a compensable taking. Under Texas State's theory of the case, the alleged taking was accomplished by the Federal Reserve in compliance with the command of Treasury and Congress. It alleged that Treasury compelled the transfer of Texas State's property to the United States.[8] We thus hold that there is no jurisdictional bar to this takings claim against the United States.

III

That is not the end of the matter. Although the Court of Federal Claims erred in dismissing the suit for lack of jurisdiction, we conclude that we may appropriately address the merits.

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[8] The government appears to dispute that this transfer was compelled in the non-statutory years but for the purposes of considering this appeal, we accept the plaintiff's well-pled allegations as true. *Leider v. United States*, 301 F.3d 1290, 1292 (Fed. Cir. 2002).

The relevant facts are not in dispute. Texas State does not assert a taking with respect to the requirement that it maintain sterile reserves with the Federal Reserve. This case turns solely on the purely legal question of whether Texas State owned a compensable property interest in the *earnings* generated by the Federal Reserve through investment of its reserves. *See, e.g.*, *Webb's*, 449 U.S. at 161; *Cermak v. Babbitt*, 234 F.3d 1356, 1361 (Fed. Cir. 2000) (holding that the nature of property interests is a question of law); *Coast Indian Cmty. v. United States*, 550 F.2d 639, 649 (Ct. Cl. 1977) (determination of plaintiffs' ownership of a compensable property interest was a question of law).

The merits of the takings claim were fully briefed twice in the Court of Federal Claims. The legal question of whether Texas State had a property interest in the earnings of the Federal Reserve was addressed at oral argument in this court, and the parties had yet another opportunity to present supplemental briefing on this issue after oral argument. In their supplemental briefing, neither party objected to our considering the merits. We conclude that it is appropriate to address the merits, and we conclude that Texas State had no property interest in the income generated by the Federal Reserve through its open market operations, and that the complaint should be dismissed for failure to state a claim. *See, e.g.*, *Helvering v. Gowran*, 302 U.S. 238, 245 (1937).

"It is axiomatic that only persons with a valid property interest at the time of the taking are entitled to compensation." *Chancellor Manor v. United States*, 331 F.3d 891, 901 (Fed. Cir. 2003). Indeed, we have previously observed that plaintiffs must identify a property interest cognizable under the Fifth Amendment as a "bedrock requirement" of any successful takings challenge. *Leider*, 301 F.3d at 1295 (citing *Wyatt v. United States*, 271 F.3d 1090, 1097 (Fed. Cir. 2001)). Here, Texas State has failed to assert a valid property interest.

Texas State argues that its property interest in the share of the net earnings of the Federal Reserve that was generated by the reserve deposits is indistinguishable from the property interests that owners of principal deposited in interest-bearing accounts claim to the interest earned in those accounts, and that decisions by the Supreme Court have held constitutional "property". App. Supp'l Br. at 7-8.

The "interest follows principal" cases relied upon by Texas State all involved situations where third parties held plaintiffs' funds in separate interest-bearing accounts. *Webb's*, 449 U.S. at 157-61; *Phillips*, 524 U.S. at 164; *Brown*, 538 U.S. at 235. In *Webb's*, a company filed a complaint of interpleader in state court against Webb and Webb's creditors, and tendered the disputed amount to the court. 449 U.S. at 156-57. The court deducted the statutorily prescribed fee for maintenance of the fund and deposited the remainder in an "assignable interest-bearing account at the highest interest" in a bank. *Id.* at 157. The Florida court ultimately ordered that the principal be paid to the claimants, but retained more than $100,000 interest earned on the principal. *Id.* at 157-158. The Supreme Court found that the court appropriation of the interest earned on the interpleader fund, in excess of a fee for services, resulted in a taking. 449 U.S. at 160-61, 164-65. The Court applied the "usual and general rule . . . that any interest on an interpleaded and deposited fund follows the principal and is to be allocated to those who are ultimately to be the owners of the principal," and held that the county's taking of the earned interest implicated the Takings Clause. *Id.* at 162, 165.

In *Phillips v. Washington Legal Foundation*, the Court addressed the question of whether interest earned on clients' funds held in IOLTA accounts in private banks constituted private property for purposes of the Takings Clause. 524 U.S. 156. Texas, like other states, required that lawyers holding nominal amounts of client funds, that would other-

wise be unable to earn interest, place such funds in a separate, interest-bearing Negotiable Order of Withdrawal (NOW) bank account (an IOLTA account). *Id.* "All agree[d] that under Texas law the principal held in IOLTA trust accounts [was] the 'private property' of the client." *Id.* at 164. The Court applied the "interest follows principal" rule set forth in *Webb's* and held that that the interest earned on client funds held in IOLTA accounts was the private property of the client for Takings Clause purposes. *Id.* at 160. The Supreme Court further clarified in *Brown v. Legal Foundation of Washington* that a *per se* taking occurred when the state then withdrew this interest and used it to pay for legal services for the indigent. *Id.* at 235. However, in that case no "just compensation" was due to the clients as a result of this taking, because "without IOLTA those funds would not have produced any net interest," *id.* at 230, and the value of compensation owed "must be measured by [the Plaintiff's] net losses rather than the public's gain," *id.* at 237. All of the additional cases relied upon by Texas State in its Supplemental Brief similarly involve claims to interest that was actually generated by specific funds according to the terms of the investment in question.[9]

In contrast to *Webb's*, *Phillips*, and *Brown*, where the deposited funds were held by third party banks, here Texas State did not provide funds to a third party that were then deposited in an interest-bearing account in a private bank, but entered into a direct depositor relationship with the Federal Reserve. Under normal principals of banking law, "the relationship between a bank and its depositor is that of debtor and creditor." *Michie on Banks and Banking*, ch. IX, § 1

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[9] *See, e.g., Schneider v. Cal. Dep't of Corr.*, 151 F.3d 1194 (9th Cir. 1998); *Hampton v. Hobbs*, 106 F.3d 1281 (6th Cir. 1997); *Gillihan v. Schillinger*, 872 F.2d 935 (10th Cir. 1989); *Morton Grove Park Dist. v. Am. Nat'l Bank & Trust Co.*, 399 N.E. 2d 1295 (Ill. 1980); *Bordy v. Smith*, 34 N.W.2d 331 (Neb. 1948).

(1994). As the Supreme Court put it almost a century ago, when a bank receives deposits, the funds "belong to the bank, become part of its general funds, and can be loaned by it as other moneys. . . . The general doctrine that upon a deposit made by a customer, . . . the title to the money . . . is immediately vested in, and becomes the property of, the bank, is not open to question." *Burton v. United States*, 196 U.S. 283, 301-02 (1905) (internal quotations omitted); *see also City of Douglas v. Fed. Reserve Bank of Dallas*, 271 U.S. 489, 492-94 (1926). A debtor/creditor relationship also existed with respect to the amounts paid to receive the Federal Reserve notes held as vault cash. Texas State conceded during oral argument that "there is no private account to which interest was credited."[10] Texas State fails to recognize that its reserve deposits, which by their own terms did not generate income, were fundamentally different from the interest-bearing accounts at issue in *Webb's*, *Brown*, and *Phillips*. And, contrary to Texas State's argument, the mere fact that Texas State was compelled to maintain the reserves on deposit by law—a requirement that is itself not challenged here—did not transform the nature of their underlying property rights. Under such circumstances, even if the funds received by the Federal Reserve were used to earn interest, Texas State did not acquire a property interest in the earnings.

Our court considered this very question in *United States Shoe Corporation v. United States*. 296 F.3d 1378 (Fed. Cir. 2002). There, exporters paid a harbor maintenance tax that was subsequently found to be unconstitutional. The tax payments were refunded, but the exporters also claimed entitlement to interest on the refunded tax under the Takings

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[10] The colloquy at oral argument proceeded as follows:

> Question: But there is no private account to which interest was credited?
>
> Answer: I agree. It's all in one big pot.

Clause. *Id.* at 1384. The exporter's takings claim alleged that the "government's retention of the interest income earned on the tax revenue [was] a continuing taking." *Id.* We noted that the "tax revenue . . . became the property of the Treasury upon payment [and] [a]ccordingly, the interest earned on the tax payments is also the property of the government." *Id.* We rejected the exporter's takings claim, and held that "for the accrued interest to rise to the level of private property, the principal must be held in an identified private account," for example, by a third party bank. *Id.* Under our decision in *United States Shoe*, Texas State had no property right to any earnings generated through the Federal Reserve's investment of its required reserves.

We again addressed this issue in *Leider v. United States*, 301 F.3d at 1290. In that case, the bankruptcy court issued a check to Leider, an unsecured creditor. *Id.* at 1293. Due to a change of address, Leider did not receive the check. *Id.* As required by statute, after Leider's check remained uncashed for 90 days, the unclaimed funds were transferred to the bankruptcy court for deposit with the United States Treasury, pending the filing of a petition claiming his distributive share. *Id.* Approximately two years later, Leider filed a petition and received Leider's share of the bankruptcy estate, without interest. *Id.* He subsequently filed a suit in the Court of Federal Claims, alleging "that the government's failure to pay interest on his distributive share of the unclaimed bankruptcy funds constituted a taking of property under the Fifth Amendment." *Id.* We found that, in contrast to the situations in *Webb's* and *Phillips*, "because there existed no interest, there was nothing that could be taken." *Id.* at 1297. "This accords with the traditional immunity of the Government from the burden of interest unless it is specifically agreed upon by contract or imposed by legislation." *United States v. Goltra*, 312 U.S. 203, 207 (1941).

So here, no deposit was made with a third party, such as a private bank, that resulted in earned interest. The mere fact that the Federal Reserve owed a debt to Texas State did not entitle Texas State to an imputed return on those funds or to a share of earnings of the Federal Reserve.

Texas State has failed to state a claim for which relief can be granted, as it had no property interest, cognizable under the Fifth Amendment, in the earnings generated by the Federal Reserve through its investment of required reserves. Texas State's lack of a property interest in the earnings generated by its mandated reserves is fatal not only to its takings claim, but also to its illegal exaction and due process claims. There can be no illegal exaction or due process violation if the money exacted was never the property of Texas State.

CONCLUSION

For the foregoing reasons, we affirm the Court of Federal Claim's dismissal of this action.

AFFIRMED

COSTS

No costs.

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

04-5126

TEXAS STATE BANK
(successor by merger to COMMUNITY BANK & TRUST),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

NEWMAN, *Circuit Judge*, concurring in part, dissenting in part.

I agree that the United States is the appropriator of the funds for which Texas State Bank claims compensation; thus it is irrelevant whether the Federal Reserve System is or is not a Non-Appropriated Funds Instrumentality (NAFI), for the requirement that the earnings on Texas State Bank's deposits with the Federal Reserve Banks must be paid over to the United States Treasury is an action of the United States. Thus I concur in the court's holding that the United States was properly before the Court of Federal Claims, and that the case was improperly dismissed on NAFI grounds.

The case should now be remanded to the Court of Federal Claims for determination of the substantive question. I respectfully dissent from the panel majority's undertaking, sua sponte and at the behest of neither party, to decide the complex questions raised by the appropriation by the United States of the earnings on the banks' Reserve deposits. This issue was not decided by the Court of Federal Claims, and no decision of the merits is presented for appellate review. It is as unfair to the parties as it is irregular for this court to reach

out and decide this complex question upon the limited post-argument briefing we requested. This appeal was taken solely on the jurisdictional NAFI question and, having decided that question, the merits require adjudication by the Court of Federal Claims.

I

Since the substantive issue is nonetheless being decided by my colleagues, I must dissent from the panel majority's misapplication of law and its unsupported conclusion. It is beyond debate that money is property, and that the earnings on that money are property. In *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) the Court stated:

> The earnings of a fund are the incidents of ownership of the fund itself and are property just as the fund itself is property.

449 U.S. at 164. Again in *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 160 (1998) the Court implemented this property right:

> The question presented by this case is whether interest earned on client funds held in [Interest on Lawyers Trust Accounts] is "private property" of either the client or the attorney for purposes of the Takings Clause of the Fifth Amendment. We hold that it is the property of the client.

Again in *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 235 (2003) the Court held that the interest earned on deposits of clients' funds is the property of the client, not of the state. Although the Court recognized that when no interest was earned none had to be paid, it is undisputed that substantial interest is here earned.[11]

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[11] In fiscal year 2000 the Federal Reserve was required to transfer net earnings of $3,752 billion to the General fund of the Treasury. App. Br. at 16, U.S. Supplemental Br. at 3.

Principal and interest are property. The post-argument brief filed by Texas Bank contained expert testimony explaining that placement of a specified percentage of banks' funds in Reserve is compulsory, that minimum deposits must be met or a penalty paid, that the banks own their Reserve deposits, and can withdraw them and trade them in the "Fed funds market." Indeed, it is not disputed that the banks own their reserve deposits. They also own the interest earned by those deposits. "The rule that 'interest follows principal' has been established under English common law since at least the mid-1700's." *Phillips*, 524 U.S. at 165. The Court in *Phillips* cited representative cases from the various states, holding that the interest is the property of the owner of the principal:

> *E.g., Freeman v. Young*, 507 So.2d 109, 110 (Ala. Civ. App. 1987) ("The earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property" (internal quotation marks omitted)); *Pomona City School Dist. v. Payne*, 9 Cal. App. 2d 510, 512, 50 P.2d 822, 823 (1935) ("[O]bviously the interest accretions belong to such owner"); *Vidal Realtors of Westport, Inc. v. Harry Bennett & Assocs., Inc.*, 1 Conn. App. 291, 297-298, 471 A.2d 658, 662 (1984) ("As long as the attached fund is used for profit, the profit . . . is impounded for the benefit of the attaching creditor and is subject to the same ultimate disposition as the principal of which it is the incident" (internal quotation marks omitted)); *Burnett v. Brito*, 478 So.2d 845, 849 (Fla. App. 1985) ("[A]ny interest earned on interpleaded and deposited funds follows the principal and shall be allocated to whomever is found entitled to the principal"); *Morton Grove Park Dist. v. American Nat. Bank & Trust Co.*, 78 Ill. 2d 353, 362-363, 35 Ill. Dec. 767, 771, 399 N.E.2d 1295, 1299 (1980) ("The earnings on the funds deposited are a mere incident of ownership of the fund itself"); *B&M Coal Corp. v. United Mine Workers*, 501 N.E.2d 401, 405 (Ind. 1986)

("[I]nterest earnings must follow the principal and be distributed to the ultimate owners of the fund"); *Unified School Dist. No. 490, Butler County v. Board of County Commissioners of Butler County*, 237 Kan. 6, 9, 697 P.2d 64, 69 (1985) ("[I]nterest follows principal"); *Pontiac School Dist. v. City of Pontiac*, 294 Mich. 708, 715-716, 294 N.W. 141, 144 (1940) ("The generally understood and applied principles that interest is merely an incident of the principal and must be accounted for"); *State Highway Comm'n v. Spainhower*, 504 S.W.2d 121, 126 (Mo. 1973) ("Interest earned by a deposit of special funds is an increment accruing thereto" (internal quotation marks omitted)); *Siroky v. Richland County*, 271 Mont. 67, 74, 894 P.2d 309, 313 (1995) ("[I]nterest earned belongs to the owner of the funds that generated the interest") . . . .

The Court's extensive list drums into consciousness the universality of the rule that interest on deposited funds belongs to the owner of the deposited funds. *Phillips*, 524 U.S. at 165 n.5. No exception has been noted.

Law and precedent leave no doubt that earnings on deposited money are the property of the depositor, not of the custodian and not of the state. If this court is to create a unique exception for bank deposits with the Federal Reserve, more support is required than the panel majority's theory that because the deposits are not labeled "interest-bearing" and the earnings are placed "in one big pot" in the Federal Reserve banks, *see* maj. op. n.10, the interest is not the property of the depositor.

Indeed, the government does not take the position that the United States owns either the deposits in Reverse banks (or the vault cash) or the interest thereon; the government's position is that the Federal Reserve owns the interest because the accounts are designated as non-interest-bearing, and thus that when Texas State Bank made the required deposits in a non-

interest-bearing account, it yielded all right to the interest earned by those deposits. That accounting argument does not support the appropriation of billions of dollars of bank depositors' property.

The United States describes its diversion of the Reserve earnings to the general Treasury as "a tax upon the Federal Reserve System." U.S. Supplemental Br. at 3 n.3. Texas State Bank observes that such a "tax" is not on the Federal Reserve System, but on all persons who place their money in banks and, absent taxing authority, raises Fifth Amendment concerns. Indeed, in some years the diversion of the Reserve income was by act of Congress, and in some years only by Treasury demand. The entire case is rife with unexplored legal, economic, and policy considerations, and the stakes are high. The ultimately correct answer to all the questions awaits resolution, for the court's decision today is as unsupported as it is premature. It demands the considered judgment, in the first instance, by the Court of Federal Claims.[12]

II.

The panel majority, justifying its treatment of this unappealed issue, states that it is simply affirming the trial court's decision on an alternative ground. However, the trial court did not decide the issue, on any ground. Only the threshold NAFI question was decided, and only the NAFI question is before us.

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[12] The majority opinion suggests that the parties "did not object" to our "considering" the merits. The parties were never told that we were going to decide the merits. Indeed, the scope of the supplemental briefing that the panel requested was not commensurate with the merits.

APPENDIX B

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

[Filed June 8, 2004]

No. 01-571C

TEXAS STATE BANK (successor by merger to
COMMUNITY BANK & TRUST),
Plaintiff,

v.

THE UNITED STATES,
Defendant.

Blake Henry Bailey, Tyler, Texas, attorney of record for plaintiff and *Walter Umphrey and Greg Thompson*, Beaumont, Texas. *J. Bennett White*, of counsel, Tyler, Texas.

Kyle Eric Chadwick, Department of Justice, Washington, D.C., with whom was *Assistant Attorney General Peter D. Keisler*, for defendant. *David M. Cohen*, Director, and *Mark A. Melnick*, Assistant Director.

OPINION

FUTEY, *Judge.*

This case comes before the court after briefing and an evidentiary hearing held on April 20, 2004. On November 8, 2002, the court issued an Order and Opinion denying defendant's motion to dismiss and cross-motions for summary judgment. In the opinion, the court noted that "[t]he nature of the property interest and the scope of the alleged appropriation are disputed and the court would benefit from further ventilation of these issues." *Cmty. Bank & Trust v. United States*, 54 Fed. Cl. 352, 360 (2002). The court found

that it was not "clear, for instance, that plaintiff's funds are placed in the type of separate, interest-bearing . . . account at issue in" potentially analogous cases. *Id.* (quotation omitted). The case was stayed, however, pending a decision by the United States Supreme Court (Supreme Court) in *Brown v. Washington Legal Found.*, 538 U.S. 216 (2003), which decided issues closely related to claims asserted by plaintiff. Both parties filed reports addressing the implications of that case for the present action. Defendant contends that this case must be dismissed for lack of jurisdiction because, *inter alia*, the Board of Governors of the Federal Reserve System (Federal Reserve) is a non-appropriated funds instrumentality (NAFI). This argument was considered by the court in its previous Order and Opinion, wherein it stated that "[i]t is not fully clear whether actions by the [Federal Reserve] or Congress has been the cause of any possible taking in every year claimed by plaintiff." The court denied "this basis of defendant's motion to dismiss and reserve[d] judgment on the relevance and consequence of the [Federal Reserve's] NAFI status until additional facts [became] available." *Cmty. Bank*, 54 Fed. Cl. at 356. Since the court's Order and Opinion, the United States Court of Appeals for the Federal Circuit (Federal Circuit) has further commented on the standards guiding NAFI cases. See *Core Concepts of Florida, Inc. v. United States*, 327 F.3d 1331 (2003); *AINS, Inc. v. United States*, 2004 WL 868461 (Fed. Cir. Apr. 23, 2004).

Factual Background

The facts of this case were outlined in the court's previous Order and Opinion. *Cmty. Bank*, 54 Fed. Cl. at 353-54. Only a brief recitation of facts relevant to the following discussion is included here. Plaintiff, Texas State Bank, is the successor by merger to Community Bank and Trust, which originally filed this action. It is a bank chartered in the state of Texas

which holds or has held reserves with Federal Reserve banks in accordance with the Monetary Control Act of 1980, Pub. L. 96-221, Title I, 94 Stat. 132 (March 31, 1980).

Plaintiff alleges that the funds in those reserve accounts accrue interest when invested by the Federal Reserve and that it is the owner of the principal in the reserve accounts. Plaintiff therefore believes it is entitled to the interest that accrues pursuant to the "interest follows principal" rule described by the Supreme Court in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) and *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998), among other cases.

Discussion

The court is obligated to consider its own jurisdiction at any time in a proceeding, whether by motion of a party or by the court *sua sponte*. *Hambsch v. United States*, 857 F.2d 763, 764 (Fed. Cir. 1988); *Arctic Corner, Inc. v. United States*, 845 F.2d 999, 1000 (Fed. Cir. 1988) ("A court may and should raise the question of its jurisdiction *sua sponte* at any time it appears in doubt."); *Miller v. United States Postal Serv.*, 231 Ct. Cl. 804, 809 (1982); RCFC 12(h)(3); see also *First Fed. Sav. Bank of Hegewisch v. United States*, 52 Fed. Cl. 774, 787 n.25 (2002).

In its initial Order and Opinion, the court stated that it was not clear from the briefs submitted whether Congress or the Federal Reserve was responsible for the taking alleged by plaintiff. The fact that in two years it appeared that Congress mandated payments from the Federal Reserve to the Treasury, the source of which was alleged earnings on plaintiff's reserve accounts, persuaded the court that in "[a]t least these two years, if liability for a taking is found, funds to satisfy judgment would come from those appropriated by Congress." *Cmty. Bank*, 54 Fed. Cl. at 356. The Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66, § 3002(a), 107

Stat. 312 (Aug. 10, 1993), states, in part, that a certain "portion of net earnings of each Federal reserve bank . . . shall be deposited in the surplus fund of the bank." A portion of such surplus funds "[d]uring fiscal years 1997 and 1998 . . . shall be transferred to the Board for transfer to the Secretary of the Treasury for deposit in the general fund of the Treasury." *Id.*

During the evidentiary hearing plaintiff argued that "[w]hatever the status of the Federal Reserve Board is as to NAFI, our claim is not against the Federal Reserve Board; it is a claim against the U.S. Treasury or the United States . . . NAFI simply does not apply to suits against the United States for funds that are part of the general revenue."[1] The briefing and testimony given by the parties have clarified the facts underlying plaintiff's claim and, therefore, the court begins by readdressing its subject matter jurisdiction.

The court will not dismiss plaintiff's complaint for lack of subject matter jurisdiction if the facts reveal any possible basis on which it might prevail. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974); see also *Lewis v. United States*, 32 Fed. Cl. 59, 62 (1994). The court must accept as true the undisputed factual allegations and construe the facts in the light most favorable to plaintiff. *Hamlet v. United States*, 873 F.2d 1414, 1415 (Fed. Cir. 1989). A plaintiff must make only a prima facie showing of jurisdictional facts through the submitted material in order to avoid dismissal. *Raymark Indus. v. United States*, 15 Cl. Ct. 334, 338 (1988) (citation omitted). If, however, the truth of jurisdictional facts is challenged, the court may consider relevant evidence in order to resolve the factual dispute. *Rocovich v. United States*, 933 F.2d 991, 994 (Fed. Cir. 1991); see also *Lewis*, 32 Fed. Cl. at 62.

The United States Court of Federal Claims (Court of Federal Claims) is a court of specific and defined jurisdiction. It

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[1] Transcript at 16.

is authorized by the Tucker Act "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." 28 U.S.C. § 1491(a)(1).

Apart from exceptions "provided by the Contract Disputes Act of 1978, every final judgment rendered by the United States Court of Federal Claims against the United States shall be paid out of any general appropriation therefor . . . ." 28 U.S.C. § 2517(a). The Federal Circuit has held this statute to limit the Court of Federal Claims' jurisdiction to cases in which a resulting judgment can be paid from appropriated funds. *Furash & Co. v. United States*, 252 F.3d 1336, 1339 (Fed. Cir. 2001) ("The jurisdictional grant in the Tucker Act is limited by the requirement that judgments awarded by the Court of Federal Claims must be paid out of appropriated funds.").

The United States Court of Claims, the predecessor to this court, long held that "[t]o be actionable *in this court*, [the agency or contract] must be one which, in the contemplation of Congress, could obligate public monies." *Kyer v. United States*, 177 Ct. Cl. 747, 751 (1966). In circumstances where "Congress has indicated that public funds shall not be involved" the court was without authority to "grant the relief requested." *Id.* at 752. Congress assumed this understanding of the court's authority when the Tucker Act was amended in 1970 to extend liability to the United States for the actions of an enumerated set of NAFIs. 28 U.S.C. § 1491(a)(1) (stating that "an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of

the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.").

The Federal Circuit has held that "absent some specific jurisdictional provision to the contrary, the Court of Federal Claims generally lacks jurisdiction over actions in which appropriated funds cannot be obligated." *Core Concepts*, 327 F.3d 1331, 1334 (Fed. Cir.), *cert. denied*, 124 S. Ct. 805 (2003). That requirement has been interpreted, however, "to mean that, when an issue arises under the non-appropriated funds doctrine, the Court of Federal Claims must exercise jurisdiction absent a clear expression by Congress that it intended to separate the agency from general revenues." *Id.* (quotation omitted). The Federal Circuit has also held that the Federal Reserve is not susceptible to suit in this court because it does not operate with appropriated funds. *Denkler v. United States*, 782 F.2d 1003, 1005 (Fed. Cir. 1986); see also *Research Triangle Inst. v. Bd. of Governors of the Fed. Reserve Sys.*, 132 F.3d 985, 989 (4th Cir. 1997) (holding "that the Tucker Act does not waive [the government's] sovereign immunity" for Federal Reserve activities.).[2]

Defendant contends that, "Community's sole claim is that the [Federal Reserve] Board possessed an obligation to pay plaintiff but failed to do so. Thus . . . the complaint must be dismissed because the United States has not consented to suit against the Board."[3] The court previously reserved judgment on this argument because it had concerns that the Federal Reserve's NAFI status was altered by the payment of Federal Reserve income to the Treasury, and because it was a statute

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[2] A notably thorough history of the NAFI doctrine has recently been provided by *AINS, Inc. v. United States*, 56 Fed. Cl. 522, 527-537 (2003).

[3] Defendant's Motion To Supplement Briefing On Defendant's Motion To Dismiss In Order To Move In The Alternative To Dismiss For Lack Of Subject Matter Jurisdiction at 3.

and not the actions of the Federal Reserve which allegedly constituted a taking.

Plaintiff argues, however, that it "has not sued the Board and is not asking the Board to pay it anything . . . . Plaintiff is not suing the Board over the failure of the Federal Reserve Banks to pay interest on reserves."[4] Plaintiff makes an analogy to *Phillips*, stating:

> In *Phillips*, the interest earned by attorneys on client funds required to be held by the attorneys was taken by the Government instead of being paid to the clients. Here, just as in *Phillips*, interest earned by the Federal Reserve Banks on Plaintiff's reserves which are required to be held with the Federal Reserve Bank and in the form of Federal Reserve notes is taken by the Government rather than being paid to the Plaintiff. The action in *Phillips* was not brought against the attorneys that earned the interest taken by the Government, nor has this action been brought against the Federal Reserve Banks which have earned the interest taken by the Government.

In both cases, the actions have been brought against the Government, the taker of the funds.[5]

It is noted that "the individual named in the suit does not change the nature of the action. . . . At issue is not whether the suit is filed against the [agency], but rather whether the United States has agreed to be sued for the actions alleged." *Lion Raisins, Inc. v. United States*, 58 Fed. Cl. 391, 396 (2003). There is, nevertheless, an equivocation on the term "taker" involved in plaintiff's argument.

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[4] Plaintiff's Response To Defendant's Motion To Supplement Briefing On Defendant's Motion To Dismiss In Order To Move In The Alternative To Dismiss For Lack Of Subject Matter Jurisdiction at 3.

[5] *Id.* at 3-4.

The Treasury has received funds from the Federal Reserve. The law that mandated such payments, however, defined those payments as "net earnings" of the Federal Reserve.[6] The calculation of those net earnings depends on the expenses of the Federal Reserve, which are largely discretionary. In fact, plaintiff has maintained that the Federal Reserve possesses discretion to pay interest on reserve accounts should it deem it proper policy: "[t]here is no statute, rule, regulation, order or policy that prevents the Federal Reserve from paying interest on reserves held by depository institutions. Indeed, the Board's Legal Division has opined that the Federal Reserve possesses authority to pay interest on reserves to depository institutions."[7] Even if "interest" on reserve accounts held by the Federal Reserve constitutes the bulk of its revenue, and the Treasury receives the net earnings from such revenue, there is no statute that specifically requires the payment of *interest* on reserve accounts to the Treasury. Were the Federal Reserve to make the interest payments on reserves to depository institutions, it would have the effect of reducing the net earnings paid to the Treasury. Assuming *arguendo*, therefore, that the payments to the Treasury were in fact a taking, the Federal Reserve and not Congress is the "taker." At bottom, despite plaintiff's argument to the contrary, its action is directed against the activities of the Federal Reserve.

The direction of the flow of funds from the Federal Reserve to the Treasury is also relevant to the court's concern about the Federal Reserve's continuing NAFI status. Determining the court's jurisdiction depends on "whether Congress has clearly expressed its intent that the agency, or the particular activity that gave rise to the dispute in question, is to be separated from general federal revenues." *Core Concepts*,

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[6] Pub. L. No. 103-66 § 3002(a), 107 Stat. 337 (Aug. 10, 1993).

[7] Plaintiff's Memorandum Of Contentions Of Fact And Law at 6.

327 F.3d at 1336. In *Core Concepts*, a contractor brought an action against FederalPrison Industries (FPI), a government owned corporation that provides work simulation programs and training for inmates of federal prisons. The Federal Circuit agreed with the Court of Federal Claims that FPI did not operate with appropriated funds and stated that whether FPI was a NAFI could be understood "through FPI's enabling legislation." *Id.* In *Denkler*, the Federal Circuit held the Federal Reserve to be a NAFI after reviewing its enabling legislation, which revealed an intention to keep the Federal Reserve separate from general federal revenues.

The crucial aspect of a *non-appropriated* funds instrumentality is whether it is authorized to obligate or spend *appropriated* funds. The Federal Circuit in *Core Concepts*, however, considered the fact that "all monies under FPI's control" were required to "be deposited into the U.S. Treasury to the credit of the Prison Industries Fund . . . ." *Id.* The designation of a particular fund satisfied the Federal Circuit that "FPI's funds are to be kept distinct from general federal revenues." *Id.* Funds are appropriated when Congress authorizes by law an agency or instrumentality "to incur obligations and to make payments *out* of the Treasury." *Andrus v. Sierra Club*, 442 U.S. 347, 359-60 n.18 (1979) (quotation omitted) (emphasis added). In this respect, the Federal Reserve is not an agency operating with appropriated funds and Congress has expressed the clear intention that its expenses be kept separate from general federal revenues. See *Denkler*, 782 F.2d at 1004. The question remains, however, whether its non-appropriated status is affected by the fact that funds are paid *into* the Treasury. The court holds that it is not.

Core Concepts noted that there was no express provision in FPI's enabling legislation preventing Congress from appropriating funds. The court held, however, that "the absence of such a statement in an agency's enabling legislation is not dispositive of the agency's NAFI status." *Core Concepts*, 327

F.3d at 1336. The Federal Circuit, therefore, looked beyond the text of the legislation to FPI's characteristics in determining whether Congress clearly expressed that it intended "to separate the agency from general federal revenues." *Furash*, 252 F.3d at 1339.

The first step, therefore, is for the court to look to enabling legislation to determine whether funds are or can be appropriated to the agency in question. If the enabling legislation is not clear or is silent, however, the court interprets *Core Concepts* to encourage a further step. In such a case, the court may look not only to an instrumentality's authority to obligate or spend funds from the Treasury, but also, among other factors, to the flow of funds from the instrumentality to the Treasury. In the case of *Core Concepts*, the Federal Circuit noted that FPI made payments to the Treasury. The fact that such payments were placed in a fund designated specifically for the instrumentality's operation, however, provided the indicia of Congress' intent to separate FPI from general federal revenues. By contrast, in the present case the Federal Reserve's payments go to the Treasury's general fund.

An implication of the *Core Concepts* rationale is that payments from an instrumentality into the general federal revenues may contribute to the determination that said instrumentality lacks NAFI status. The Federal Circuit has not held, however, that a payment from an instrumentality to the general fund alone marks the absence of intent by Congress to confer NAFI status, and the court will not construe it as such. To elevate an implication of *Core Concepts* into a rule expanding the court's jurisdiction would be to treat lightly the fact that this court is one of specific and defined jurisdiction. *United States v. Testan*, 424 U.S. 392, 397-98 (1975); *United States v. King*, 395 U.S. 1, 3 (1969); *Dynalectron Corp. v. United States*, 4 Cl. Ct. 424, 428, *aff'd*, 758 F.2d 665 (Fed. Cir. 1984).

The court's jurisdiction to entertain claims and to grant relief extends only so far as the United States has waived its sovereign immunity from suit. *Testan*, 424 U.S. at 399 (citing *United States v. Sherwood*, 312 U.S. 584, 596 (1941)); *Booth v. United States*, 990 F.2d 617, 619 (Fed. Cir. 1993). The waiver of sovereign immunity must be expressed unequivocally and cannot be implied, *United States v. Mitchell*, 445 U.S. 535, 539 (1980), and any grant of jurisdiction to this court must be strictly construed. *Id.*; *Cosmic Constr. Co. v. United States*, 697 F.2d 1389, 1390 (Fed. Cir. 1982). Further, the Federal Circuit has recently reiterated its determination that the Federal Reserve is a NAFI, although without any particular discussion of the payments from the Federal Reserve to the Treasury. *AINS, Inc.*, 2004 WL 868461, at *5. The court concludes, therefore, that the Federal Reserve remains a NAFI, despite the 1997 and 1998 mandated payments of net revenue to the Treasury.

The court expresses no opinion as to whether the payment of the Federal Reserve's net earnings to the Treasury requires compensation under the Fifth Amendment to the depository institutions required to maintain reserves. Absent the NAFI doctrine, it would be necessary for the court to determine whether: plaintiff has a protected property interest in the reserve account; the Federal Reserve earns interest in the meaning of *Webb's* and *Phillips* on required reserve accounts; the payment of any such interest is a taking. As it is, however, the court has no power to hear and decide those issues.

In addition to its takings claim, plaintiff asserts that "[d]efendant's actions constitute an 'illegal exaction' of property in violation of the Fifth Amendment Due Process Clause, since the Federal Reserve has, in effect, confiscated interest on required reserves . . . ."[8] An illegal exaction claim is one in which "the plaintiff has paid money over to the Government,

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[8] Plaintiff's Motion For Partial Summary Judgment at 25.

directly or in effect, and seeks return of all or part of that sum . . . improperly paid, exacted, or taken from the claimant in contravention of the Constitution, a statute, or a regulation." *Eastport S.S. Corp. v. United States*, 178 Ct. Cl. 599, 605 (1967). The relationship between the Tucker Act and the court's jurisdiction over illegal exactions has been explained by the following:

> As recognized in *United States v. Testan*, a Tucker Act claim for damages against the United States . . . may take one of two forms: a claim under a money-mandating statute or a claim for money improperly exacted or retained. A claimant must rely either on a statute that mandates payment of money from the government to the claimant or on an illegal exaction, that is, a payment to the government by the claimant that is obtained without statutory authority. The first is founded on statutory authorization; the second on the absence of statutory authorization. One is the flip side of the other.

Aerolineas Argentinas v. United States, 77 F.3d 1564, 1579 (Fed. Cir. 1996) (Nies, S.J., *concurring*) (citations omitted).

In this case, plaintiff argues that the Federal Reserve's retention and payment to the Treasury of alleged interest on its required reserves is, in effect, money exacted without constitutional authority. Regardless of whether this proposition is true, the argument is unavailing. The fact that plaintiff's claim is constitutional and not statutory, whether founded on the takings clause or a due process violation, cannot cure the court's lack of jurisdiction. It has been noted by this court that, "[t]he Fifth Amendment itself does not provide a tribunal for every suit . . . . Therefore, in order for this court to hear a Fifth Amendment claim, it must fit both within the Tucker Act and within the limitation placed on the Court by 28 U.S.C. § 2517, which authorizes the payment of judgments only from appropriated funds." *Lion Raisins*, 58 Fed. Cl. at 397 (citation omitted).

As this court stated in *AINS, Inc. v. United States*:

> We have thus come full circle and returned to what this case is really about: sovereign immunity. Until Congress lifts sovereign immunity and allows at least some suits against these large NAFIs, what very well could be a vested right in common circumstance cannot be vindicated in this court. "The Government of the United States has been emphatically termed a government of laws, not of men. It will certainly cease to deserve this high appellation if the laws furnish no remedy for the violation of a legal vested right." *Marbury v. Madison*, 1 Cranch 137, 163 (1803).

56 Fed. Cl. 522, 544 (2003).

The court concludes, therefore, that it has no subject matter jurisdiction to consider either plaintiff's takings or illegal exaction claims.

It is acknowledged that a consequence of this judgment is that plaintiff is left without a judicial forum in which to have its claims remedied if the actions of the Federal Reserve in fact be a taking or illegal exaction. The Supreme Court has held, however, that when "the United States . . . creates rights in individuals against itself," it "is under no obligation to provide a remedy through the courts." *United States v. Babcock*, 250 U.S. 328, 331 (1919). "[T]hat is because there was no surrender of sovereign immunity in the plan of the [Constitutional] convention; so that, for suits against the United States, it remained 'inherent in the nature of sovereignty not to be amenable to suit of an individual without its consent.'" *Glidden v. Zdanok*, 370 U.S. 530, 563-64 (1962) (quoting THE FEDERALIST, NO. 81, at 511 (Alexander Hamilton) (Wright ed., 1961)). This is evidenced by the fact that for nearly one hundred years after the adoption of the Constitution there was no judicial tribunal to resolve takings claims. See *Lion Raisins, Inc. v. United States*, 57 Fed. Cl. 435, 437-

38 (2003). "As a result of the barrier of sovereign immunity, the laws controlling governmental rights and obligations could not for years obtain a fully definitive exposition. The creation of the Court of Claims can be viewed as a fulfillment of the design of Article III." *Glidden*, 370 U.S. at 557. When Congress created this court, however, it did not include jurisdiction over NAFIs. It has since expanded such jurisdiction only to NAFIs enumerated in the 1970 amendment to the Tucker Act, which does not encompass the Federal Reserve. All that apparently remains to plaintiff, therefore, are legislative appeals or non-monetary claims in prayer of alternative relief as may be pursued in another forum.

Conclusion

For the above-stated reasons, the Clerk of the Court is hereby directed to DISMISS the complaint for lack of subject matter jurisdiction. All pending motions in this case are MOOT. No costs.

IT IS SO ORDERED. BOHDAN A. FUTEY, *Judge*

APPENDIX C

UNITED STATES COURT OF FEDERAL CLAIMS

[Filed November 8, 2002]

No. 01-571C

COMMUNITY BANK & TRUST on behalf of itself and all others similarly situated,

Plaintiff,

v.

THE UNITED STATES,

Defendant.

OPINION and ORDER

FUTEY, *Judge.*

This takings case is before the court on defendant's motion to dismiss and plaintiff's motion for partial summary judgment. Defendant argues that plaintiff's claim has not been timely filed and fails to state a valid takings claim. Defendant asserts also that this court lacks subject matter jurisdiction over the claim. Plaintiff Community Bank and Trust ("Community") opposes dismissal and cross-moves for summary judgment as to liability for an alleged taking.

Factual Background

Plaintiff is a bank chartered by the state of Texas and has been in operation since 1935.[1] In 1980 the United States Congress ("Congress") passed the *Monetary Control Act,* Pub. L. 96-221, Title I, 94 Stat. 132 ("MCA"). The act requires all banks to maintain certain funds in their vaults and

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[1] Appendix (App.) to Defendant's (Def.'s) Motion (Mot.) to Dismiss at 17.

in reserve accounts at the Federal Reserve Bank. Plaintiff alleges that the Federal Reserve derives income from those funds and passes the income to the United States Treasury ("Treasury") each year. Plaintiff asserts that such income is the bank's property and the payment of this income to the United States constitutes a taking.

The Federal Reserve system is the nation's central bank. It was established by Congress in 1913 to implement monetary policy and control aspects of the banking industry, among other purposes. On the authority of the Federal Reserve Act, twelve regional reserve banks were created to further these ends. The Reserve Banks act to implement monetary policy at the direction of the Board of Governors of the Federal Reserve ("Board of Governors"). The Federal Reserve also provides various commercial services to member banks such as check clearing, wire transferring, and the safekeeping of securities.[2]

Initially, only national banks (*i.e.*, those chartered by the Comptroller of the Currency) were required to become members of the Federal Reserve system. State-chartered banks had the option of joining and many did, in part to receive the system's commercial services. Maintaining "sterile" reserves against checking accounts and other deposits, pursuant to the Federal Reserve Act, is a significant cost of membership. The reserves are considered "sterile" because the funds so designated cannot be used for other purposes.

Reserves are held in either of two forms: deposits at the Federal Reserve Bank or as Federal Reserve Notes stored at the member bank, otherwise known as "vault cash." 12 U.S.C. § 461(c). Deposits at the Federal Reserve Bank are non-interest bearing.[3] Funds deposited as reserves are un-

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[2] Federal Reserve Act of 1913, Pub. L. No. 63-43, 39 Stat. 251.

[3] Complaint P 9.

available to be loaned out. Holding cash in a bank's vault likewise precludes those funds from being loaned out, resulting in the same loss of income opportunity.

The high rates of inflation during the late 1970s increased the cost to banks of maintaining reserves. In response, some state-chartered banks dropped their Federal Reserve membership, thereby avoiding the need to maintain a reserve account with the Federal Reserve Bank. Congress soon sought to reverse this trend since the Federal Reserve's capacity to implement monetary policy is in some measure dependent on the size of reserve deposits. The MCA increased deposits by requiring reserves not only from national banks, but also from state-chartered banks and depository institutions with no Federal Reserve membership. Plaintiff has maintained the required reserves as vault cash and in accounts with the Federal Reserve since 1980.

> Plaintiff alleges that the funds in its reserve account are used by the Federal Reserve to purchase Treasury securities and to make loans to other banks, and that such investments by the Federal Reserve earn interest.[4] It also alleges a mechanism by which its vault cash is used by the Federal Reserve to offset purchases of Treasury securities which in turn generate income for the Federal Reserve. Plaintiff states that interest and other net earnings of the Federal Reserve bank are paid each year to the Treasury.[5] In addition, plaintiff alleges that it is the owner of this income following the rule that "interest follows principal" as recognized in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 66 L. Ed. 2d 358, 101 S. Ct. 446 (1980) and *Phillips v. Washington Legal Found.*, 524 U.S. 156, 141 L. Ed. 2d

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[4] *Id.* P 6.

[5] Plaintiff's (Pl.'s) Reply (Rep.) to Def.'s Opposition (Opp'n) to Pl.'s Mot. for Partial Summary Judgment (Summ. J.) at 8-9 and n.8.

174, 118 S. Ct. 1925 (1998). Plaintiff asserts, therefore, that defendant has taken its property by paying the income to the Treasury.

Defendant acknowledges that Treasury securities are purchased with the funds deposited by plaintiff, that such investments earn income, and that the income is paid to the Treasury.[6] Defendant argues, however, that once funds are deposited with the Federal Reserve the money belongs to the Federal Reserve. Following the "interest follows principal" rule, defendant concludes that any interest on such funds belongs to defendant and, therefore, nothing owned by plaintiff is taken.

Discussion

I. Motion to Dismiss

Plaintiff filed its complaint on October 3, 2001. On January 4, 2002, defendant filed a motion to dismiss. Defendant asserted that plaintiff's claim is barred by the statute of limitations, that plaintiff fails to state a valid takings claim, and that any potential claim predicated on an "illegal exaction" under due process is beyond the jurisdiction of this court. Defendant supplemented its motion to dismiss on June 12, 2002,[7] asserting a lack of subject matter jurisdiction.

In ruling on a motion to dismiss for lack of jurisdiction under RCFC 12(b)(1), the court must accept as true the complaint's undisputed factual allegations and construe the facts in the light most favorable to plaintiff. *See Scheuer v. Rhodes*, 416 U.S. 232, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974); *see also Hamlet v. United States*, 873 F.2d 1414, 1415 (Fed. Cir. 1989); *Farmers Grain Co. v. United States*, 29 Fed. Cl.

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[6] Def.'s Opp'n to Pl.'s Mot. for Partial Summ. J. at 2.

[7] Def.'s Mot. to Supplement Briefing on Def.'s Mot. to Dismiss in Order to Move in the Alternative to Dismiss for Lack of Subject Matter Jurisdiction at 3.

684, 686 (1993). A plaintiff must make only a prima facie showing of jurisdictional facts through the submitted material in order to avoid a defendant's motion to dismiss. *See Raymark Indus. v. United States*, 15 Cl. Ct. 334, 338 (1988) (citing *Data Disc, Inc. v. Systems Tech. Assocs., Inc.*, 557 F.2d 1280, 1285 (9th Cir. 1977)). If the undisputed facts reveal any possible basis on which the non-moving party might prevail, the court must deny the motion. *See Scheuer*, 416 U.S. at 236; *see also Lewis v. United States*, 32 Fed. Cl. 59, 62 (1994). If, however, the motion challenges the truth of the jurisdictional facts alleged in the complaint, the court may consider relevant evidence in order to resolve the factual dispute. *See Rocovich v. United States*, 933 F.2d 991, 994 (Fed. Cir. 1991); *see also Lewis*, 32 Fed. Cl. at 62.

A. Time-Barred

Plaintiff brings its taking claim pursuant to the Tucker Act, 28 U.S.C. § 1491(a)(1) (1994). Actions brought under the Tucker Act are time-barred if they are not filed within six years of the date the cause of action accrued. 28 U.S.C. § 2501 (1994). The court's six-year statute of limitations is a jurisdictional requirement which must be strictly construed. *Catellus Dev. Corp. v. United States*, 31 Fed. Cl. 399, 404 (1994); *see also Bear Claw Tribe, Inc. v. United States*, 36 Fed. Cl. 181, 187 (1996) (citing *Hopland Band of Pomo Indians v. United States*, 855 F.2d 1573, 1577 (Fed. Cir. 1988)). Plaintiff bears the burden of proving that its action was timely filed. *Mason v. United States*, 27 Fed. Cl. 832, 836 (1993). The court may not waive the statute of limitations. *Laughlin v. United States*, 22 Cl. Ct. 85, 99 (1990), aff'd mem., 975 F.2d 869 (Fed. Cir. 1992). In sum, a plaintiff's failure to comply with the statute of limitations "places the claim beyond the court's power to hear and decide." *Catellus*, 31 Fed. Cl. at 404.

Determining when a taking cause of action accrues "must often be done in a somewhat imprecise manner . . . ." *Barnes*

v. United States, 210 Ct. Cl. 467, 480, 538 F.2d 865 (1976); *see also Catellus*, 31 Fed. Cl. at 404. Generally, a taking cause of action first accrues when "all the events . . . which fix the government's alleged liability have occurred *and* the plaintiff was or should have been aware of their existence." *Hopland Band*, 855 F.2d at 1577 (emphasis in original); *see also Japanese War Notes Claimants Ass'n v. United States*, 178 Ct. Cl. 630, 373 F.2d 356 (1967), *cert. denied*, 389 U.S. 971, 19 L. Ed. 2d 461, 88 S. Ct. 466 (1967). The court determines whether the pertinent events have occurred under an objective standard. *Fallini v. United States*, 56 F.3d 1378, 1380 (Fed. Cir. 1995), *cert. denied*, 517 U.S. 1243 (1996). A cause of action can accrue, therefore, even if plaintiff does not possess actual knowledge of all relevant facts.

Defendant asserts that the actions giving rise to plaintiff's complaint accrued in 1980 at the time the MCA was passed by Congress, well beyond the six-year limitation.[8] Plaintiff counters that an independent decision is made each year by the Board of Governors to pay interest in that year to the Treasury. Plaintiff contends that this yearly determination establishes a continuing claim.[9]

Plaintiff further contends that the statute of limitations should be tolled. Plaintiff does not deny that all facts required to bring a claim were available in 1980 when the MCA was implemented. It argues, however, that certain actions of the defendant led plaintiff to believe that no viable cause of action existed.[10] What plaintiff believes is not determinative. It is not necessary that plaintiff be certain of the merits of the claim or the extent of damages before filing suit. *Boling v. United States*, 220 F.3d 1365, 1371 (Fed. Cir. 2000) (rejecting proposition that filing of a lawsuit can be postponed until

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[8] Def.'s Mot. to Dismiss at 8.

[9] Pl.'s Response (Resp.) to Def.'s Mot. to Dismiss at 14-16.

[10] *Id.* at 18.

full extent of damages is known); *Catawba Indian Tribe of South Carolina v. United States*, 982 F.2d 1564 (Fed. Cir. 1993) (holding that misunderstanding as to meaning of law does not toll accrual of cause of action when all relevant facts are known). Plaintiff need only be aware of sufficient facts to know a wrong occurred. *Japanese War Notes*, 178 Ct. Cl. at 631. The court concludes, therefore, that only the last six years of plaintiff's claim are within the court's jurisdiction.

Whether the full six years of plaintiff's claim can be maintained on the basis of the continuing claims doctrine need not be resolved at this stage of the proceeding. In 1997 and 1998 it was a public law of Congress that mandated the payment of interest from the Federal Reserve deposit accounts to the Treasury. Omnibus Budget Reconciliation Act, Pub. L. 103-66, § 3002 (a), 107 Stat. 312. Whatever the final effect of the statute of limitations, a cause of action has accrued within the six-year jurisdictional requirement for, at minimum, the 1997 and 1998 payments of income to the Treasury.

B. Jurisdiction: Non-Appropriated Funds Instrumentality

Defendant contends that plaintiff's argument presents a dilemma: the taking occurred either at the time Congress passed the MCA, in which event the statute of limitations for its cause of action has long since run, or plaintiff is asserting that yearly discretionary decisions by the Board of Governors, and not Congress, are responsible for the taking. If the latter, defendant argues that the Board of Governors is a non-appropriated financial instrumentality ("NAFI") not within the jurisdiction of this court.[11]

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[11] Def.'s Mot. to Supplement Briefing on Def.'s Mot. to Dismiss in Order to Move in the Alternative to Dismiss for Lack of Subject Matter Jurisdiction at 1.

NAFIs are "federal government entities whose 'monies do not come from congressional appropriation but rather primarily from [their] own activities, services, and product sales.'" *El-Sheikh v. United States*, 177 F.3d 1321, 1322 (Fed. Cir. 1999) (quoting *Cosme Nieves v. Deshler*, 786 F.2d 445, 446 (1st Cir. 1986)). The United States Court of Appeals for the Federal Circuit ("Federal Circuit") has held that the Board of Governors is an NAFI. *Denkler v. United States*, 782 F.2d 1003, 1005 (Fed. Cir. 1986). Judgments awarded by the United States Court of Federal Claims must be paid out of appropriated funds, 28 U.S.C. § 2517. It has been held that this court lacks jurisdiction to entertain actions against non-appropriated funds instrumentalities where the judgment could not be paid from a source of appropriated funds. *Furash & Co. v. United States*, 252 F.3d 1336, 1339 (Fed. Cir. 2001).

It is not fully clear whether actions by the Board of Governors or Congress has been the cause of any possible taking in every year claimed by plaintiff.[12] The fact that in two years Congress has caused the payment of interest to the Treasury, however, again militates in favor of plaintiff. At least for these two years, if liability for a taking is found, funds to satisfy judgment would come from those appropriated by Congress. Therefore, the court denies this basis of defendant's motion to dismiss and reserves judgment on the relevance and consequence of the Board of Governors' NAFI status until additional facts are available.

C. Failure to State a Valid Takings Claim

Defendant argues that plaintiff fails to state a claim upon which relief may be granted and seeks to dismiss the claim pursuant to RCFC 12(b)(6). First, defendant states that plaintiff has no property interest in the interest or other income

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[12] *Id.* at 3.

earned by the Federal Reserve. Second, were the court to find that plaintiff holds a property interest, defendant claims that the payment of that income to the Treasury does not constitute a taking.

The court will grant such a motion only if it appears beyond a doubt that plaintiff has failed to allege facts sufficient to support the claim. *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957); *Mostowy v. United States*, 966 F.2d 668, 672 (Fed. Cir. 1992). In ruling on an RCFC 12(b)(6) motion to dismiss, the court must accept as true the complaint's undisputed factual allegations and should construe them in a light most favorable to plaintiff. *Papasan v. Allain*, 478 U.S. 265, 283, 92 L. Ed. 2d 209, 106 S. Ct. 2932 (1986) (citing *Scheuer v. Rhodes*, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974); *Gould, Inc. v. United States*, 935 F.2d 1271, 1274 (Fed. Cir. 1991). Nevertheless, "conclusory allegations unsupported by any factual assertions will not withstand a motion to dismiss." *Briscoe v. LaHue*, 663 F.2d 713, 723 (7th Cir. 1981), *aff'd*, 460 U.S. 325, 75 L. Ed. 2d 96, 103 S. Ct. 1108 (1983). "Legal conclusions, deductions, or opinions couched as factual allegations are not given a presumption of truthfulness." *Blaze Constr., Inc. v. United States*, 27 Fed. Cl. 646, 650 (1993) (internal quotations omitted).

The Fifth Amendment to the Constitution states that "private property" shall not "be taken for public use, without just compensation." U.S. CONST. amend. V. In order to present a valid claim for a compensable taking, a claimant must allege and prove that (1) it has a specific property interest, and (2) the government has appropriated that interest, leaving the claimant without the use or benefit of that interest. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1027-29, 120 L. Ed. 2d 798, 112 S. Ct. 2886 (1992). First, the court will look to the threshold requirement: whether plaintiff has identified a property interest cognizable under the Fifth Amendment. *M&J*

Coal Co. v. United States, 47 F.3d 1148, 1154 (Fed. Cir. 1995). The property interest claimed by plaintiff is the income earned as interest on the funds it deposits with the Federal Reserve and income allegedly derived by the Federal Reserve on plaintiff's cash reserves.

Defendant argues that plaintiff is not the owner of the funds held on its account at the Federal Reserve and, therefore, can have no cognizable interest in the income derived from those funds. Defendant states:

> A deposit by a depository institution in a Reserve bank account in order to meet reserve requirements is a deposit, and a deposit results in a change in the legal ownership of the amount deposited, creating a debtor-creditor relationship between the Reserve bank and the depository institution that makes the deposit. Accordingly, the Reserve bank properly becomes the "owner" of the principal, and has a legal right to the earnings thereon.[13]

Second, defendant states that when plaintiff chooses to hold vault cash rather than a reserve account at the Federal Reserve bank, plaintiff "provides the issuing Federal Reserve Bank with no funds in which Community has any ownership interest. Thus, there are no funds held by the Reserve Bank related to Federal Reserve notes the earnings of which belong to [Community]."[14]

Defendant cites several cases that describe the legal relationship of a bank to its depositor which are fairly represented by the statement that "when a general deposit is made, title to the deposited funds passes immediately to the bank in exchange for a promise by the bank to refund the same amount,

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[13] Def.'s Mot. to Dismiss at 15.

[14] *Id.* at 13-14.

or a portion thereof, on demand, and the bank may use the money for its own profit." *United States v. BCCI Holdings (Luxembourg), S.A.*, 814 F. Supp. 106, 109 (D.D.C. 1993).

It cannot be said, however, that this statement holds for all types of accounts, among all types of banks and depositors. Plaintiff argues that *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 66 L. Ed. 2d 358, 101 S. Ct. 446 (1980) and *Phillips v. Washington Legal Found.*, 524 U.S. 156, 141 L. Ed. 2d 174, 118 S. Ct. 1925 (1998) are better precedents for the current case. The *Webb's* case involved interest that accrued to an interpleaded fund, deposited with the clerk of the Florida court, and held in a bank account. The United States Supreme Court ("Supreme Court") found a cognizable property interest in the principal, despite the fact that the money was paid over first to the clerk, then deposited with a bank. *Webb's*, 449 U.S. at 161.

Phillips perhaps more directly involves a plaintiff's property right in funds deposited with a bank. Under the Texas Interest on Lawyers Trust Account (IOLTA) program, an attorney who received client funds was required to place them in an interest-bearing account. The interest was then paid to the Texas Equal Access to Justice Foundation, which financed legal services for indigent clients. The Supreme Court found that under Texas law the principal held in IOLTA accounts was the property of the client. *Phillips*, 524 U.S. at 164.

Defendant argues that:

> Funds deposited with a bank become the property of the bank, and the depositor obtains, in exchange, a claim on the bank's assets, becoming a general creditor of the bank. The bank's earnings on assets funded by deposited monies likewise belong to the bank, and its obligation to

> pay interest on the depositor's claim is determined by the contractual arrangement between them . . .[15]

Defendant's proposition is true among depositors choosing to place their funds with a private bank. *Webb's* and *Phillips* indicate, however, that this is not the necessary rule where the law abrogates this choice, mandating the deposit or the use to which any interest is put.

The existence of a property interest is determined by reference to "existing rules or understandings that stem from an independent source such as state law." *Phillips*, 524 U.S. at 164 (quoting *Bd. of Regents of State Colleges v. Roth*, 408 U.S. 564, 577, 33 L. Ed. 2d 548, 92 S. Ct. 2701 (1972)). The Fifth Amendment protects such interests, but does not create them. *Id.*

Phillips and *Webb's* both recognize, however, that there are circumstances in which a client or company can have a property interest cognizable under the Fifth Amendment in the principal of a bank account. *Phillips*, 524 U.S. at 164 ("all agree that under Texas law the principal held in IOLTA trust accounts is the 'private property' of the client."); *Webb's*, 449 U.S. at 161 ("The creditors thus had a state-created property right to their respective portions of the fund."). This property interest is greater than the simple right to withdraw like funds.

In addition, plaintiff asserts that it is the beneficial owner of the principal deposited with the Federal Reserve. Plaintiff argues that such an interest is enough to establish a right to the bank account and its accrued interest even if legal title is held by the Federal Reserve.

Both parties urge the court to consider two recent decisions of the Federal Circuit in determining whether plaintiff has a cognizable property interest: *United States Shoe Corp. v.*

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[15] Def.'s Rep. to Pl.'s Resp. to Def.'s Mot. to Dismiss at 2.

United States, 296 F.3d 1378 (Fed. Cir. 2002) and *Leider v. United States*, 301 F.3d 1290 (Fed. Cir. 2001). The plaintiffs in both cases claimed a right to accrued interest on funds held by the government.

Leider was a creditor owed a distributive share of a bankruptcy settlement. A failed attempt was made by the government to contact and pay Leider. Unable to send payment, Leider's funds were held by the government for approximately two years. When Leider finally received his share of the settlement it did not include interest for the delay. Leider asserted a right to such interest and brought a claim to recover it. The court rejected the claim because, as a factual matter, the government did not invest the funds and so "interest was never earned on the funds." *Leider*, 301 F.3d at 1296. In addition, the court held that the relevant law did not "impose an obligation on the government to earn and disburse interest." Id. It is not clear how this reasoning applies to the current case. *Leider* is taken to mean that there is no duty on the government to earn interest on deposited funds and, when no interest has been earned, nothing has been taken. By contrast, in the present case, the Federal Reserve does put to work the principal that plaintiff has deposited and income appears to be derived from it.

In *U.S. Shoe*, an exporter paid a user-fee type tax into the Harbor Maintenance Trust Fund. The Supreme Court, however, ultimately ruled that the tax was unconstitutional. As a result, U.S. Shoe was entitled to a refund of the money it had paid. U.S. Shoe asserted a right to recover not only the tax payments but interest as well. The Federal Circuit ruled that no prejudgment interest was due. The court held that the tax paid by U.S. Shoe "became the property of the Treasury upon payment . . . ." *U.S. Shoe*, 296 F.3d at 1384. Applying the same "interest follows principal" rule recognized by *Phillips*, the Federal Circuit determined that "the interest earned on the tax payments is also the property of the government." *Id.*

Plaintiff notes, however, that the ownership of funds in U.S. Shoe can be distinguished from that in *Phillips*. The Federal Circuit states that "the tax revenue here was not held by the government as property of U.S. Shoe." *Id.* Unlike U.S. Shoe, in *Phillips*, *Webb's*, and the present case, the principal deposited pursuant to the various statutes is held with the clear view of being returned or otherwise used for the benefit of the depositor.

For the limited purpose of this motion to dismiss, the court finds that plaintiff has a property interest in the principal of its reserve accounts, cognizable under the Fifth Amendment. Precedent indicates such an interest and defendant does not adequately argue otherwise. A more thorough examination during pretrial and trial proceedings of the nature of reserve accounts, vault cash, and how income accrues from those funds may, of course, ultimately lead to a different conclusion.

Where a property interest is recognized, the court must consider whether plaintiff has failed to allege facts sufficient to state a valid takings claim. *See Conley*, 355 U.S. at 45-46. Defendant argues that no such facts are evident. Even if a cognizable property interest can be found, defendant asserts, plaintiff "makes a claim only as to one strand of its property—the strand of the earnings derived by the Federal Reserve on those assets." Defendant argues that "the destruction of one 'strand' of the bundle [of property rights] is not [necessarily] a taking, because the aggregate must be viewed in its entirety."[16] This argument amounts to the assertion that a *per se* analysis is improper when the property at issue is money rather than real property.

Defendant further argues that an *ad hoc* analysis demonstrates plaintiff's lack of a valid claim. In brief, defendant

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[16] Def.'s Rep. to Pl.'s Resp. to Def.'s Mot. to Dismiss at 13 (citing *Andrus v. Allard*, 444 U.S. 51, 66-68, 62 L. Ed. 2d 210, 100 S. Ct. 318 (1979)).

states that plaintiff has not alleged any facts to show that it suffered a significant economic impact by the passage of the MCA; that it had no investment-backed expectations to the interest income that flows from the reserve deposits; and that the character of the government action does not provide any basis for a heightened analysis of the payment of interest income to the Treasury.[17]

The United States Court of Appeals for the Fifth Circuit ("Fifth Circuit"), however, has recently applied a *per se* analysis to takings of money. *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 270 F.3d 180, 185 (5th Cir. 2001) *reh'g denied en banc*, 293 F.3d 242 (5th Cir. 2002), *petition for cert. filed sub nom., Phillips v. Washington Legal Found.*, 71 U.S.L.W. 3092 (U.S. June 26, 2002) (No. 02-1). The government's appropriation of interest in Webb's was also found to be a categorical taking, although it was decided prior to the widespread use of the term *per se* to describe such takings. Whether a *per se* or *ad hoc* analysis applies to the current case, however, cannot be determined without a more thorough definition of plaintiff's property right. A valid claim may attach both to plaintiff's vault cash and reserve account claim, to one and not the other, or neither. A final determination requires a more detailed ventilation of the facts of how these funds are used by the Federal Reserve.

The court finds that plaintiff has stated a claim upon which relief may be granted.

II. Plaintiff's Motion for Partial Summary Judgment

Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. RCFC 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 91 L. Ed. 2d 202, 106

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[17] *Id.*

S. Ct. 2505 (1986); *Jay v. Secretary of Dep't of Health & Human Servs.*, 998 F.2d 979 (Fed. Cir. 1993). A fact is material if it might significantly affect the outcome of the suit under the governing law. *Liberty Lobby*, 477 U.S. at 248. The party moving for summary judgment bears the initial burden of demonstrating the absence of any genuine issues of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986). If the moving party demonstrates an absence of a genuine issue of material fact, the burden then shifts to the opposing party to show that a genuine issue exists. *Sweats Fashions, Inc. v. Pannill Knitting Co.*, 833 F.2d 1560, 1563 (Fed. Cir. 1987). Alternatively, if the moving party can show that there is an absence of evidence to support the opposing party's case, the burden then shifts to the opposing party to proffer such evidence. *Celotex*, 477 U.S. at 325. The court must resolve any doubts about factual issues in favor of the party opposing summary judgment, *Litton Indus. Prods., Inc. v. Solid State Sys. Corp.*, 755 F.2d 158, 163 (Fed. Cir. 1985), to whom the benefits of all favorable inferences and presumptions run. *H.F. Allen Orchards v. United States*, 749 F.2d 1571, 1574 (Fed. Cir. 1984), *cert. denied*, 474 U.S. 818, 88 L. Ed. 2d 52, 106 S. Ct. 64 (1985).

Plaintiff argues that the payment of interest on its principal to the Treasury is a taking as matter of law. It is acknowledged that even where takings questions are highly dependent on a fact-intensive analysis, summary judgment may be appropriate. See 67 *Third Ave. Assocs. v. United States*, 48 F.3d 1575, 1580 (Fed. Cir. 1995). The court is further aware that defendant also believes that "this case should be determined as a matter of law" and that "there exist no material facts relating to plaintiff's motion" at all.[18] Summary judgment is nevertheless not appropriate in this case. The nature

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[18] Def.'s Statement of Genuine Issues in Opp'n to Pl.'s Mot. for Summ. J. at 1.

of the property interest and the scope of alleged appropriation are disputed and the court would benefit from further ventilation of these issues. *Yuba Goldfields, Inc. v. United States*, 723 F.2d 884, 887 (Fed. Cir. 1983); *Philadelphia Suburban Corp. v. United States*, 217 Ct. Cl. 705, 707 (1978).

One key element of plaintiff's claim is a determination of whether the reserve account principal is the property of plaintiff or the Federal Reserve. As noted above, this question has been addressed recently by the Fifth Circuit. That court has said of a case involving an IOLTA bank account that "the linchpin for this case has already been inserted by the Supreme Court: 'interest income [. . .] is the "private property" of the owner of the principal.'" *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 270 F.3d 180, 188 (5th Cir. 2001), *reh'g denied en banc, Washington Legal Found. v. Texas Equal Access to Justice Found.* 293 F.3d 242 (5th Cir. 2002), *petition for cert. filed sub nom., Phillips v. Washington Legal Found.*, 71 U.S.L.W. 3092 (U.S. June 26, 2002) (quoting *Phillips*, 524 U.S. at 172). The court concluded that "because the State has permanently appropriated [the] interest income . . . instead of merely regulating its use, there is a *per se* taking." *Id.* (Comparing *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432, 73 L. Ed. 2d 868, 102 S. Ct. 3164 (1982) with *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978)). A contrary United States Court of Appeals for the Ninth Circuit case has recently been accepted for review by the Supreme Court, *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835 (9th Cir. 2001), *cert. granted*, 70 U.S.L.W. (U.S. June 10, 2002) (No. 01-1325), and a petition to join the Fifth Circuit case has been filed.[19]

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[19] *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 293 F.3d 242 (5th Cir. 2002) (*reh'g denied en banc*), petition for cert.

The Federal Circuit has not addressed this subject and the court declines to follow the Fifth Circuit's decision, particularly while the petition for certiorari is pending.[20] There exists ambiguity as to both the nature of reserve accounts and the income derived from them. It is not clear, for instance, that plaintiff's funds are placed in the type of "separate, interest-bearing . . . account" at issue in IOLTA cases. *Phillips, 524 U.S. at 161*. Further, while income is in some manner derived from funds deposited by plaintiff at the Federal Reserve, the amount of income cannot be determined by a simple calculation. The sums that plaintiff describes as interest on reserves may include more than interest, according to the common meaning of that term. What is given to the Treasury each year as "interest on reserves" is in fact a percentage of the net earnings of the Federal Reserve, derived only in part from the investment of the reserve funds.[21]

It is also questionable whether a taking of "interest" is the proper description of plaintiff's claim related to its cash reserves. It is argued that the funds held by plaintiff as reserves are used by the Federal Reserve to invest and earn income. The mechanism by which the Federal Reserve allegedly appropriates the funds in plaintiff's possession is less than clear. Plaintiff argues that its sterile reserves in some way provide the Federal Reserve with more net income than it would have otherwise achieved. Since plaintiff's capital makes possible this additional revenue, plaintiff implies that it is owner of those increased earnings. That proposition appears far divorced from the narrow rule of Phillips declaring that "interest follows principal" where it can be ascribed to individual, private accounts.

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filed sub nom., *Phillips v. Washington Legal Found.*, 71 U.S.L.W. 3092 (U.S. June 26, 2002) (No. 02-1).

[20] *Id.*

[21] App. to Pl.'s Resp. to Def.'s Mot. to Dismiss at 64.

Further, it cannot yet be determined whether a *per se* or *ad hoc* analysis is applicable to the facts at issue. Whether defendant's actions constitute the total deprivation of an entire property interest, or are more akin to regulation, can be determined only by a more informed analysis. Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. RCFC 56(c). This is not the case here.

In addition to its takings claim plaintiff asserts that defendant's payment of interest on reserve accounts "constitute an 'illegal exaction' of property . . . since the Federal Reserve has . . . confiscated interest on required reserves that belongs to the Plaintiff . . . ."[22] As with the takings claim, this claim depends on a determination by the court that plaintiff has a property interest in the reserve accounts sufficient to invoke the "interest follows principal rule." Judgment on the illegal exaction claim is reserved until the property interest and its implications for the takings claim are decided.

Conclusion

For the above stated reasons, defendant's motion to dismiss for timeliness is DENIED-IN-PART and ALLOWED-IN-PART. Plaintiff's claim is limited to the statutory six years prior to the date of its complaint. Defendant's motion to dismiss for failure to state a claim and its supplemental motion for lack of subject matter jurisdiction are DENIED. Plaintiff's cross-motion for partial summary judgment is DENIED. A status conference concerning pretrial proceedings and class certification shall be held at the National Courts Building, in Washington, D.C., on Wednesday, December 11, 2002, at 2:30 p.m.

IT IS SO ORDERED.

BOHDAN A. FUTEY, *Judge*

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[22] Pl.'s Mot. for Partial Summ. J. at 25.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

04-5126

TEXAS STATE BANK (successor by merger to
COMMUNITY BANK & TRUST),
Plaintiff-Appellant,

v.

UNITED STATES,
Defendant-Appellee.

December 13, 2005, Decided
December 13, 2005, Filed

ORDER

A combined petition for panel rehearing and for rehearing en banc having been filed by the APPELLANT, and a response thereto having been invited by the court and filed by the APPELLEE, and the petition for rehearing having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on December 20, 2005.

APPENDIX E

Constitutional Provisions, Statutes and Rules

U.S. Constitution, Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Federal Statutes

12 U.S.C § 248a. Pricing of Services

(a) Publication of pricing principles and proposed schedule of fees; effective date of schedule of fees

Not later than the first day of the sixth month after March 31, 1980, the Board shall publish for public comment a set of pricing principles in accordance with this section and a proposed schedule of fees based upon those principles for Federal Reserve bank services to depository institutions, and not later than the first day of the eighteenth month after March 31, 1980, the Board shall begin to put into effect a schedule of fees for such services which is based on those principles.

* * * * *

(c) Criteria applicable

The schedule of fees prescribed pursuant to this section shall be based on the following principles:

* * * * *

(2) All Federal Reserve bank services covered by the fee schedule shall be available to nonmember depository institutions and such services shall be priced at the same fee schedule applicable to member banks, except that nonmembers shall be subject to any other terms, including a requirement of balances sufficient for clearing purposes, that the Board may determine are applicable to member banks.

* * * * *

12 U.S.C § 341. General enumeration of powers

Upon the filing of the organization certificate with the Comptroller of the Currency a Federal Reserve bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power—

First. To adopt and use a corporate seal.

Second. To have succession after February 25, 1927, until dissolved by Act of Congress or until forfeiture of franchise for violation of law.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law or equity.

Fifth. To appoint by its board of directors a president, vice presidents, and such officers and employees as are not otherwise provided for in this chapter, to define their duties, require bonds for them and fix the penalty thereof, and to dismiss at pleasure such officers or employees. The president shall be the chief executive officer of the bank and shall be appointed by the board of directors, with the approval of the Board of Governors of the Federal Reserve System, for a term of five years; and all other executive officers and all employees of the bank shall be directly responsible to him. The first vice president of the bank shall be appointed in the same manner and for the same term as the president, and shall, in the absence or disability of the president or during a

vacancy in the office of president, serve as chief executive officer of the bank. Whenever a vacancy shall occur in the office of the president or the first vice president, it shall be filled in the manner provided for original appointments; and the person so appointed shall hold office until the expiration of the term of his predecessor.

Sixth. To prescribe by its board of directors, bylaws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed.

Seventh. To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this chapter and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this chapter.

Eighth. Upon deposit with the Treasurer of the United States of any bonds of the United States in the manner provided by existing law relating to national banks, to receive from the Secretary of the Treasury circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited, such notes to be issued under the same conditions and provisions of law as relate to the issue of circulating notes of national banks secured by bonds of the United States bearing the circulating privilege, except that the issue of such notes shall not be limited to the capital stock of such Federal Reserve bank.

But no Federal Reserve bank shall transact any business except such as is incidental and necessarily preliminary to its organization until it has been authorized by the Comptroller of the Currency to commence business under the provisions of this chapter.

* * * * *

12 U.S.C § 414. Authority of Board of Governors respecting issuance of notes; interest; lien

The Board of Governors of the Federal Reserve System shall have the right, acting through the Federal Reserve agent, to grant in whole or in part, or to reject entirely the application of any Federal Reserve bank for Federal Reserve notes; but to the extent that such application may be granted the Board of Governors of the Federal Reserve System shall, through its local Federal Reserve agent, supply Federal Reserve notes to the banks so applying, and such bank shall be charged with the amount of the notes issued to it and shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on only that amount of such notes which equals the total amount of its outstanding Federal Reserve notes less the amount of gold certificates held by the Federal Reserve agent as collateral security. Federal Reserve notes issued to any such bank shall, upon delivery, together with such notes of such Federal Reserve bank as may be issued under subchapter XIII of this chapter upon security of United States 2 per centum Government bonds, become a first and paramount lien on all the assets of such bank.

* * * * *

12 U.S.C § 461. Reserve requirements

* * * * *

(b) Additional definitions; required amounts of reserves maintained against transaction accounts; waiver of ratio limits in extraordinary circumstances; supplemental reserves; reserves related to foreign obligations or assets; exemption for certain deposits; discount and borrowing; transitional adjustments; additional exemptions and waivers

* * * * *

(2)(A) Each depository institution shall maintain reserves against its transaction accounts as the Board may prescribe by regulation solely for the purpose of implementing monetary policy—

(i) in the ratio of 3 per centum for that portion of its total transaction accounts of $25,000,000 or less, subject to subparagraph (C); and

(ii) in the ratio of 12 per centum, or in such other ratio as the Board may prescribe not greater than 14 per centum and not less than 8 per centum, for that portion of its total transaction accounts in excess of $25,000,000, subject to subparagraph (C).

(B) Each depository institution shall maintain reserves against its nonpersonal time deposits in the ratio of 3 per centum, or in such other ratio not greater than 9 per centum and not less than zero per centum as the Board may prescribe by regulation solely for the purpose of implementing monetary policy.

* * * * *

(D) Any reserve requirement imposed under this subsection shall be uniformly applied to all transaction accounts at all depository institutions. Reserve requirements imposed under this subsection shall be uniformly applied to nonpersonal time deposits at all depository institutions, except that such requirements may vary by the maturity of such deposits.

* * * * *

(c) Promulgation of rules and regulations respecting maintenance of balances

(1) Reserves held by a depository institution to meet the requirements imposed pursuant to subsection (b) of this section shall, subject to such rules and regulations as the Board shall prescribe, be in the form of—

(A) balances maintained for such purposes by such depository institution in the Federal Reserve bank of which it is a member or at which it maintains an account, except that (i) the Board may, by regulation or order, permit depository institutions to maintain all or a portion of their required reserves in the form of vault cash, except that any portion so permitted shall be identical for all depository institutions, and (ii) vault cash may be used to satisfy any supplemental reserve requirement imposed pursuant to subsection (b)(4) of this section, except that all such vault cash shall be excluded from any computation of earnings pursuant to subsection (b)(4)(C) of this section; and

(B) balances maintained by a depository institution which is not a member bank in a depository institution which maintains required reserve balances at a Federal Reserve bank, in a Federal Home Loan Bank, or in the National Credit Union Administration Central Liquidity Facility, if such depository institution, Federal Home Loan Bank, or National Credit Union Administration Central Liquidity Facility maintains such funds in the form of balances in a Federal Reserve bank of which it is a member or at which it maintains an account. Balances received by a depository institution from a second depository institution and used to satisfy the reserve requirement imposed on such second depository institution by this section shall not be subject to the reserve requirements of this section imposed on such first depository institution, and shall not be subject to assessments or reserves imposed on such first depository institution pursuant to section 7 of the Federal Deposit Insurance Act (12 U.S.C. 1817), section 404 of the National Housing Act (12 U.S.C. 1727), * * * or section 202 of the Federal Credit Union Act (12 U.S.C. 1782). * * *

(2) The balances maintained to meet the reserve requirements of subsection (b) of this section by a depository institution in a Federal Reserve bank or passed through a Federal

Home Loan Bank or the National Credit Union Administration Central Liquidity Facility or another depository institution to a Federal Reserve bank may be used to satisfy liquidity requirements which may be imposed under other provisions of Federal or State law.

* * * * *

12 U.S.C. § 464. Checking against and withdrawal of reserve balance

The required balance carried by a member bank with a Federal Reserve Bank may, under the regulations and subject to such penalties as may be prescribed by the Board of Governors of the Federal Reserve System, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities.

* * * * *

Code of Federal Regulations

12 C.F.R. § 204.1. Authority, purpose and scope

* * * * *

(c) Scope. (1) The following depository institutions are required to maintain reserves in accordance with this part:

(i) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)) or any bank that is eligible to apply to become an insured bank under section 5 of such Act (12 U.S.C. 1815);

(ii) Any savings bank or mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(f), (g));

(iii) Any insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752(7)) or any credit union that is eligible to apply to become an insured credit union under section 201 of such Act (12 U.S.C. 1781);

(iv) Any member as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422(4)); and

(v) Any insured institution as defined in section 401 of the National Housing Act (12 U.S.C. 1724(a)) or any institution which is eligible to apply to become an insured institution under section 403 of such Act (12 U.S.C. 1726).

* * * * *

Sec. 204.3. Computation and maintenance

* * * * *

(b) Form and location of reserves. (1) A depository institution, a U.S. branch or agency of a foreign bank, and an Edge or Agreement corporation shall hold reserves in the form of vault cash, a balance maintained directly with the Federal Reserve Bank in the Federal Reserve District in which it is located, or, in the case of nonmember institutions, with a pass-through correspondent in accordance with Sec. 204.3(i).

* * * * *

APPENDIX F

Transcript of Evidentiary Hearing, *Community Bank & Trust v. United States*, No. 01-CV-571, Prof. George Benston, Apr. 20, 2004, 57-58 (Docket # 101)

Q: Now, in terms of the reserves of depository institution, both in bulk and balances that are maintained at the reserve bank, would that be reflected on the balance sheet of the Federal Reserve Bank as well?

A: Well, they would be liabilities.

Q: Yes.

A: Here it is. Basically, you see that we have deposits of depository institutions. That's line 23 there, and those are those required reserves, but there are also more that required reserves. There are the required reserves and the reserves that the banks hold against their transactions to pay for effectively the various services that the Federal Reserve gives them. So some part of this is required reserves, and some part of it is the compensating reserves that the banks keep effectively to pay for the services that they get from the Federal Reserve.

Q: Do you have any idea roughly—on line 23, it shows that the depository institutions keep roughly $25 billion in their accounts that the Federal Reserve—roughly how much they keep in terms of required reserves?

A: Right now, I think it's about half and half. If I recall correctly, around $12 billion is in the required reserves, and 13 in the compensated reserves.

* * * * *

Tr. at 60-61

Q: Why don't we put that up now? Is this the document that you created—

A: Yes, it is.

Q: —to explain how interest on Federal Reserve notes is calculated?

A: Yes.

Q: Could you explain to the Court how that's done?

A: Yes. What we have is you take the Federal Reserve net earnings—the "net" refers to after dividends they are required to pay and the expenses and the difference to be paid in capital, if any, and that's the net earnings. I guess, if they wanted to, or if they felt they had the authority to, they could just simply say, here it is, giving it to the treasury, but they don't do it that way, although that's really what they are doing. They take that number, and they divide the Federal Reserve notes outstanding into that number, and they get a number. If you divide one number by another number, remarkably, you get a third number, and the third number in this case happens to be—of course, those are the real numbers—the "B" is billion—and it turns out to be 3.3 percent, but it is what it is. And then they take that 3.3 percent, and they multiply it against the Federal Reserve notes which they have, and, lo and behold, they come up with the earnings, and they say, "See? We're giving you interest on those notes," but they are just giving you your earnings.

* * * * *

Tr. at 89-91

Q: Well, let's start with the latter, since that's specifically at issue here. When a depository institution makes a deposit into an account at a Federal Reserve Bank, you said that the depository institution has an asset—correct?—that corresponds to the amount deposited. Correct?

A: Yes.

Q: But the asset that the depository institution owns is a claim against the Federal Reserve Bank. Isn't that correct?

A: That's correct.

Q: And the corresponding liability on the books of the Federal Reserve Bank is, in fact, a claim against that bank, against the Federal Reserve Bank.

A: Yes, the claim owed by the Federal Reserve Bank.

Q: Correct. But if we think of the funds themselves, if we can imagine the colored money, if you will, if there is a certain amount of funds that are deposited at the Federal Reserve Bank, the Federal Reserve Bank then owns those funds to do with as it wishes. Isn't that correct?

A: Well, not quite. It owns the funds, surely, but what the claim is that the banks have against the Fed is against the assets in which those fund are employed.

Q: Let's go to the case that you mentioned. If you or I or Judge Futey make a deposit into our bank, consumer bank, what we own in exchange for making that deposit is claimed against the bank, our bank. Correct?

A: That's correct.

Q: Is that directly analogous to the type of claim that a depository institution owns when it makes a deposit with a Federal Reserve Bank?

A: No. There is a very important difference. The difference is that if you make a deposit in a bank, you as an individual or a business, you do have a claim against the bank, but you have a voluntary contractual relationship with that bank. You decide under what terms that you will give the bank funds, what services they will give you in exchange or what interest they will give you if they are permitted to pay interest, and so forth. So it's a voluntary relationship. With the Federal Reserve, it's not a voluntary relationship; it's a required relationship. Banks must put. They can't say well, I would rather keep it somewhere else. They must deposit the funds; and, therefore, they have a claim not only on the funds but upon the way those funds are used, the return of those funds. Their claim is on the return that the funds would otherwise earn that if it were a voluntary relationship, they would get.

Q: Well, that's not quite true, is it? The bank can, in fact, use vault cash to satisfy its reserve requirements 100 percent.

A: Well, they really can't. They can in the sense that they legally are permitted—no, I have to take that back. They are legally permitted to do so in the sense that the regulations say that they can meet their reserve requirements that way, but they can't physically do so because they would have to get vault space. The bank examiners would certainly criticize them if they kept that much money in a vault and correctly so. And so while technically they can do it, in actuality, they can't.

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APPENDIX G

Transcript of Evidentiary Hearing, Community Bank & Trust v. United States, No. 01-CV-571, Prof. Michael Woodford, Apr. 20, 2004, 125-126 (Docket # 101)

Q: Professor Woodford, we've been talking about required reserves in general. I think we've had testimony that, in fact, there are two components of those reserves: the reserve deposits and vault cash. Would it be possible for the Federal Reserve to pay interest on vault cash as well as to pay interest on reserve deposits? How would they do that, if it is possible?

A: I believe that would be fairly easy for them to do. As we reviewed earlier today, the depository institutions are required to report to the reserve banks on the quantity of vault cash, among other things, that they are holding because this is something that has to be measured in each of these two-week, reserve-maintenance periods to verify that the reserve requirement is being satisfied. Also, these depository institutions have accounts with the reserve bank and so there is both the information needed to pay interest on their vault cash and the accounts that directly credit with the interest on the vault cash. And so from that point of view, it would seem to me quite practical to make those payments were it to be judged desirable to do so.

* * * * *

Tr. at 139-140

Q: I think Professor Benston was asked this question by Mr. Chadwick, and I'm going to ask it to you. Is there a difference between a bank voluntarily holding an account with another bank that does not pay interest and holding required reserve deposits with a Federal Reserve Bank?

A: I would see a difference, and the difference is that a bank that voluntarily chooses to hold a deposit that doesn't earn interest and is doing this voluntarily is, therefore, pre-

sumably receiving some benefit from the account, which accounts for their willingness to enter into that contract. In the case of the nonpayment of interest on required reserves, there is no voluntary decision of the depository institutions and, therefore, no reason to presume that they are, in fact, receiving a benefit equal in value to what they are giving out.

* * * * *

Tr. at 150-51

Q: When I make a deposit to my own bank, using the same sort of hypothetical construct, what is the economically desirable size of my claim against my bank?

A: Well, again, this is something that you're free to contract with your bank, and so presumably you do receive both pecuniary returns and convenience returns and services from your bank, a combination of these three things that are of equal value to the alternative uses of your funds. The difference there and what happens in the case of required reserves is that the depository institutions don't have a choice about whether the level of balances they are holding with the Fed is the one that they would judge privately justifiable from the point of view other services they might be receiving or other convenience that this might have for their business activities.

Q: The assumption there being that, in other words, that I, just as an example, am a rational consumer of financial services and can make my own decision.

A: That's right.

Q: And if it were left voluntary for the banks, depository institutions, with respect to whether they should have monies on deposit at the Federal Reserve, how would they go about making that decision? How would they make a rational decision?

A: Then they would be comparing the benefits that they did receive to the opportunity cost, and under those circumstances, there would surely be some balances still held with

the Fed for, say, convenience of carrying out payments, but I suspect quite a bit smaller balances than the ones that are currently held, given that they also have double balances to satisfy reserve requirements.

APPENDIX H

Michie on Banks and Banking, Ch. IX, § 1 (1994)

§ 1. In General[2]

General Deposit Creates Relation of Debtor and Creditor.— Ordinarily the relation between a bank and its depositor is that of debtor and creditor.[3] And this is the case, except under special circumstances or where there is a statute to the contrary, when a deposit is made upon general account. * * *

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[2] As to duty of bank as to exhibition of accounts of depositors, see § 308 of this chapter.

[3] [footnotes to caselaw omitted)]

APPENDIX I

Authority of the Board to Pay Interest on Required Reserves of Member Banks, Mem. to Bd. of Governors of the Fed. Reserve Sys. from the Legal Div. (June 19, 1978)

June 19, 1978*

To: Board of Governors
From: Legal Division (Messrs. Petersen, Raiken, and Schwartz)

Subject: Authority of the Board to pay interest on required reserves of member banks

Introduction:

This memorandum considers the question of whether the Federal Reserve System is empowered to pay interest on the reserves that member banks maintain in the form of balances at the Federal Reserve Banks. In examining this question, this memorandum considers the permissibility under the Federal Reserve Act of providing a return on reserve maintained by member banks in the form of direct payments to member banks by Federal Reserve Banks.

In view of the current discussions concerning membership and charges for System services, the Legal Division has prepared this memorandum in order to review the Board's legal authority to pay interest on member bank reserves. In the course of its review of this question, the Legal Division has also taken into account prior consideration that has been given to the issue of compensating member banks for reserves held within the System.

Summary:

The question of the payment of interest on reserves has been considered by the Board and by Congress on several occasions since the 1913 passage of the Federal Reserve Act.

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* Revised from original draft memorandum of December 10, 1976.

In examining this matter, the Legal Division has considered the legislative history of the Act, the express and implied powers under the Act of the Board and the Reserve Banks, the events of the early years of the System, various legislative proposals concerning the distribution of excess earnings to members, the National Bank Act, and the Banking Act of 1933.

At the outset it should be noted that the Federal Reserve Act does not expressly authorize the Federal Reserve Banks to pay interest on reserves of members. On the other hand, the Act contains no express prohibition against such payment. In fact, the relevant legislative history reveals that Congress discussed at length the issue of the payment of interest on reserves and expressly recognized that the Act would remain silent on this matter.

On the basis of this review, the Legal Division believes it is reasonable to conclude that the decision to pay interest on reserves has been left to the System's discretion and that the express and implied powers granted by the Federal Reserve Act may reasonably be construed as the bases for the authority to pay interest on reserves.

Legislative History

A review of the legislative history of the Federal Reserve Act reveals the circumstances relating to Congress' determination to enact legislation that did not expressly authorize or expressly prohibit the payment of interest on reserves.

The original bill to create the Federal Reserve System was introduced by Congressman Glass as H.R. 7837 on August 29, 1913. This bill contained the following provision under GOVERNMENT DEPOSITS, SEC. 16:

> The Secretary of the Treasury shall, subject to the approval of the Federal reserve board, from time to time, apportion the funds of the Government among the said

> Federal reserve banks, distributing them, as far as practicable, equitably between different sections, and may, at their joint discretion, charge interest thereon and fix, from month to month, a rate which shall be regularly paid by the banks holding such deposits: *Provided*, That no Federal reserve bank shall pay interest upon any deposits except those of the United States.

(See House Report, September 19, 1913, p. 122.)[1]

Even though no interest payments on private deposits were to be allowed, Section 7 of the House bill allowed member banks to share in the profits of the Reserve banks. Specifically, section 7 provided for the following division of earnings:

(a) a 5 per cent dividend to stockholding member banks;

(b) one-half of the remaining net earnings were to be devoted to surplus (until such surplus amounted to 20 per cent of the capital of the bank);

(c) the remaining one-half of the net earnings was to be divided three-fifths to the U.S. government and *two-fifths to the member banks in the ratio of their average balances with the Federal Reserve Bank for the preceding year.* (See House Report No. 69 September 19, 1913, p. 38.) (Emphasis added)

In the substitute bill offered by Senator Owen on December 1, 1913, both of these provisions were deleted. No explanation was given for the deletion.[2] Senator Owen's bill was supported by only half of the Senate Committee on Banking and Currency.[3] The version of the bill favored by other com-

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[1] H.R. Rep. No. 69, 63d Congress, 1st Sess. (1913); hereinafter "House Report."

[2] 51 Cong. Rec. 21 (December 1, 1913).

[3] S. Rep. No. 133, Part 2, 63d Congress, 1st Sess. (1913), p. 3; hereinafter "Senate Report."

mittee members proscribed the payment of interest on deposits of member banks and eliminated the proposed divisions of earnings. (Senate Report, Part 3 at pp. 10, 15).

The question of interest on reserves and the equitable division of earnings was actively debated on the floor of the Senate. On December 18, 1913, Senator Nelson discussed the prohibition against interest payments:

> I may say in this connection that while a great majority of the banks of the New York Clearing House approved of it [the prohibition against payment of interest] and would have adopted the plan there was a very small minority that refused to acquiesce. The result was that the rule recommended by this committee [New York Clearing House Committee to study panic of 1873] was not adopted. * * *
>
> I refer to these matters not so much for the purpose of criticizing anybody as for the purpose of enabling us to draw a lesson therefrom; and that lesson has been utilized in a concrete form in two of the pending currency bills by entirely changing the system of reserves and by prohibiting the payment of interest on such reserves and the payment of interest on deposits in the reserve banks. [51 Cong. Rec. 450, 451]

As noted previously, the original proscription was included as a provision in the section on government deposits. It can be argued that its omission, when that section was redrafted, was inadvertent. This possibility was discussed by Senator Nelson during the Senate debates:

> I may say in this connection that the original Glass bill prohibits the payment of interest on all deposits except on the deposit of Government funds. The Hitchcock bill is along the same lines, and prohibits the payment of interest on bank deposits in the Reserve Banks, while the last print of the Owen bill, if my recollection serves me

right, is silent on that subject . . . I rather think it was unintentional.

MR. O'GORMAN. My understanding is that interest will not be paid on deposits made by member banks, and will not be paid on deposits made by the Federal Government.

MR. NELSON. It is not indicated in the last print of the bill that that is so. [51 Cong. Rec. 451]

Later, Senator Nelson again stressed that, despite the personal conclusions of some of the Senators, there was no express prohibition in the redraft of the Owen bill.

MR. SHAFROTH. I am not certain, but I am satisfied that there is no power whatever given to these banks to pay any interest on deposits made with them.

MR. NELSON. There is no express power to do so, but there is no inhibition against it. [51 Cong. Rec. 451]

In fact, Senator Reed even pointed out the exact location of the previous prohibition, and noted its omission from the final Senate bill.

MR. REED. To clear up the matter, I will state that in the Owen bill, as it appears in its last print, section 16 of the old bill becomes section 15 of the present bill . . . It covers largely the same subject matter as the same section of the Glass bill; but the latter had at the end of the section as it appeared there these words:

Provided, That no Federal reserve bank shall pay interest upon any deposits except those of the United States.

MR. NELSON. Yes; that is what I referred to.

MR. REED. That language does not appear in the same place in the Owen bill, and I do not think it appears elsewhere in the bill.

> MR. NELSON. That is my understanding—that it does not appear anywhere in the last print of the Owen bill. [51 Cong. Rec. 451]

After discussing the possibility of paying interest on government deposits, Mr. Nelson continued:

> What I am concerned about more that anything else is the payment of interest by the reserve banks to their depositors. Unless that is prohibited we fall back into the old and dangerous rut of the present reserve system.
>
> MR. WILLIAMS. That would seem to fall within the powers of the reserve board. [51 Cong. Rec. 452]

If, as Senator Williams believed, the Board had authority to *prohibit* interest payments, it would follow that the Board also had the power to *authorize* Reserve Banks to make such payment.

It should be noted that in their discussion, the Senators often stated that the Reserve Banks "will not" pay interest—not that they "could not" or "cannot" pay interest. The Senate Report on the Owen bill states that:

> The reserves placed with the Federal reserve banks would not bear interest under the present bill (although this may possibly be found expedient at some future time when the system is established) . . . .[4]

The revisions that occurred during the development of the Act are highly significant and help clarify the intent of the drafters of the bill. The supporters of the original House bill clearly felt that, while interest should not be allowed on reserve balances, member banks should still share proportionately in any excess earnings of the Federal Reserve Banks. The supporters of the Senate version of the bill, however, felt that member banks should not have an absolute right to a

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[4] Senate Report, Part 2, p. 12.

proportionate share of the profits and also believed that the Federal Reserve System should not be expressly prohibited from paying interest on reserve balances.

On the basis of the full and complete discussion of the omission of the express prohibition contained in the House and Hitchcock bills, we believe that it is fair to conclude that the Congress intentionally excluded from the Act any express prohibition on the payment of interest on reserves and that they did not wish to foreclose such possibility if the System found such action desirable or necessary at some later time.

Should the Federal Reserve Act Be Regarded As Containing An Implied Prohibition Against the Payment of Interest on Reserves

If the Congress in 1913 intended to prohibit by implication the Board's authorizing the payment of interest on reserves, that intent should be revealed by an examination of the reasons given for the proposed express prohibition. If the reasons were weak then, or if they have lost validity over the years, it would be inappropriate at this time to find an implied prohibition now.

The reasons given for the prohibition against payment of interest on reserves that had been considered by Congress can be summarized as follows:

(1) Under the then-widespread practice of pyramided reserves, funds were drawn away from the country banks, where they could have been used for agricultural loans, to the New York banks where they could earn interest.

(2) The new system would result in lower reserve requirements for national banks, thus freeing more funds for lending. The income from these newly freed funds would more than compensate for the interest lost on reserves.

(3) The loss of interest was a quid pro quo for the privilege of a national charter and membership in the System with its inherent benefits.

(4) The Federal Reserve Banks needed to build up surplus for use in emergencies, and the payment of interest would delay the process of building surplus.

(5) Member banks would be adequately compensated by access to the discount window, and by any other services which the system might provide to members in the future.

These reasons have lost the validity under today's circumstances and, indeed, as indicated below, existing conditions support recognition of an implied authority to make such payments.

1. *The drawing of funds to New York.* During the Senate discussion of the Owen bill, the concern over the drain of funds caused by the policies of the New York banks was constantly raised. In a representative colloquy, Senator Williams stated:

> The viciousness of the present system consists in the fact that what ought to be the reserve of the country, held subject to instantaneous call, in order to protect the country bank or the reserve city bank, finds itself wrapped up in New York and it cannot be gotten away . . . . If you do not let them earn interest, the deposit never will be made, except so much as the law compels to be made.
>
> MR. NELSON. That is all the better; that is what makes the system safe. There is where the Senator from Mississippi fails to draw a lesson from our present reserve system. It is not only that they pay interest on the required reserves they deposit, but they pay interest on all the deposits of the country banks, and by that

> means draw the money to New York or other reserve centers. The country banks, instead of keeping the money at home, send it to the New York or other reserve centers for the sake of getting 2 per cent interest. And then the banks in the reserve cities loan it out on stock collateral as call loans, which, in cases of great emergency, cannot readily be converted into cash.
>
> The seat of the difficulty, to my mind, is the payment of interest by the banks on bank deposits. [*51 Cong. Rec.* 452]

Under the Federal Reserve Act, reserves would not be drawn to one location (New York), but would be spread among the Reserve Banks, remaining close to the nation's agricultural and industrial centers. In addition, the Reserve Banks would not loan money for stock market speculation as the New York banks had. While the Senators' concerns may have been valid under the old system, the same types of problems and abuses ordinarily would not arise under the Federal Reserve System as structured.

2. *The benefits of lowered reserve requirements.* This was a valid argument in 1913 and probably remained valid for several years thereafter. The member banks were benefited by the freeing of funds which originally had been part of their required reserves. But the benefits which accrued to member banks over 60 years long since have been overshadowed by subsequent developments.

3. *The privileges of a national charter.* The advantages of national bank charter as opposed to a state bank charter may be less apparent today especially in view of the burden of sterile system reserve requirements that national banks must bear.

4. *The need to build surplus.* Until the Reserve Banks built up sufficient surplus to be able to operate effectively in time of fiscal emergencies, the System's financial soundness was

uncertain. They needed funds for such things as buildings, equipment, and staff. Thus, the concern that the payment of interest might delay the accumulation of surplus was probably justified. But by 1920 the Reserve Banks were strong and secure, and their present strength deprives this argument of any present validity. Last year the Reserve Banks paid $5.9 billion in earnings to the Treasury. A reasonable program that includes the payment of interest on reserves would not affect the financial soundness of the Reserve Banks.

5. *Services provided by the Federal Reserve.* Member bank access to the discount window historically has been viewed as a very valuable privilege. During the formative years of the System, other services were added, including the free delivery of coin and currency, check clearing facilities, and wire services. When Reserve Bank profits started to rise during World War I and the pressure increased for the payment of interest on reserves or other forms of compensation, the Board pointed to these services as compensating for lost interest income. In recent years check collection and other Federal Reserve services have been valuable to member banks, and do partially offset the burden of maintaining sterile reserves. But the availability of some Federal Reserve services to nonmembers, the availability of alternative correspondent services and the pressure for increased earnings diminish the value of Federal Reserve membership even though these services are provided at no additional charge to member banks.

The continued erosion of System membership indicates clearly that access to the discount window and other services currently provided without charge to member banks are inadequate compensation for the burden of sterile reserves. Moreover, members of Congress and others have urged establishment of, and the Board has indicated its intention to develop, a system of explicit pricing for services provided. To the extent that member banks in the future are required to

pay for the System services they receive, the burden of maintaining sterile reserves increases, and the historical rational that free services "compensate" member banks for required reserves loses its validity.

The First Two Decades

The framers of the Federal Reserve Act did not contemplate that the Federal Reserve Banks should operate with a substantial financial surplus and, in fact, in the early years of the System, some of the Banks had difficulty earning amounts sufficient to pay operating expenses. Until 1916 only the Federal Reserve Bank of Richmond had been able to pay the statutory 6 per cent dividend to stockholding member banks and it was not until 1918 that all of the Federal Reserve Banks had paid their dividends in full. [Letter x-1914a, April 22, 1920]

However, with the entry of the U.S. into World War I in 1917 came the necessity of raising funds to finance the War through bond issues. This resulted in a great credit expansion and unusually high earnings for the Federal Reserve Banks. After the conclusion of the war, a number of legislative proposals were introduced to require the System to return some or all of its excess earnings to member banks. These proposals included direct payment of interest on reserves, payment of an additional dividend to member banks, and direct pro rata distribution based on reserves or capital stock or both. The following list, though probably not exhaustive, is representative:

S. 3773	1/22/20 (Mr. Gore) Payment of interest on reserves at the rate prevailing in the reserve or central reserve cities.
H.R. 12849	3/1/20 (Mr. Goodykoontz) Payment of 2 per cent interest on reserves.

S. 4103	12/16/23 (Mr. Lenroot) Extra dividend of up to 3 per cent when earnings exceed 12 per cent.
H.R. 3206	12/13/23 (Mr. Fulmer) Payment of 2 per cent interest on reserve balances.
S. 2321	2/14/24 (Mr. Shields) Payment of 2 per cent interest on reserve balances.
S. 5571	1/26/29 (Mr. Glass) Additional dividend of up to 2 per cent.
H.R. 7966	1/6/30 (Mr. McFadden) Pro rata distribution based on reserve balances up to maximum of $500,000.
S. 5723	2/4/30 (Mr. Glass) One-half of excess earnings to member banks as extra dividend.
S. 3564	2/15/30 (Mr. Fletcher) 90 per cent of earnings pro rata to stockholders.
H.R. 10211	2/24/30 (Mr. Stegall) Earnings from note issue to government; excess earnings pro rata to stockholders.
H.R. 10472	3/4/30 (Mr. Wingo) Pro rata distribution of earnings at the end of each year.
S. 1905	9/15/41 (Mr. Wiley) Payment of interest on reserves; rate of interest not specified.
H.R. 12865	3/30/76 (Mr. Allen) Payment of interest of not less that 1 per cent under the discount rate, on reserve balances.
S. 1873 (later S. 2055)	7/15/77 (Mr. McIntyre) Limits payment of interest of required reserves to 5 per cent of Reserve Bank net earnings.

Almost without exception these bills were directory, stating that the Board was "obligated and required" to pay interest, or that interest on earnings "shall be paid," "shall be distributed," or "shall be divided." From the mandatory tone of these bills, it is reasonable to conclude that the drafters intended to force the Board into exercising *existing* authority, which for policy reasons it had been reluctant to exercise. Two other Senate bills (S. 5571 and S. 4103) were phrased permissively and dealt only with extra dividends, not interest on reserves. S. 1873 (later S. 2055) was regarded by the Board as confirming the Board's implied authority and as establishing a limit on the amount of interest that may be paid by the Federal Reserve.

Although the Board had expressed opposition to bills requiring distribution of excess earnings, at times individual Board members have expressed support for additional discretionary distribution of System earnings to member banks. In a letter dated January 13, 1923, to the Secretary of the Treasury, Vice Governor Platt stated:

> though the Federal Reserve Board has never approved any of them before [bills requiring additional dividends] I think it may be said that some of them have been discussed by the Board with the idea that something of the kind might be done to offset the agitation for payment of interest on reserve deposits and also as some extra inducement to increase the membership of State banks.

In a personal letter to a Georgia banker on June 1, 1923, Governor Harding stated that he had recommended that a bill include a provision that:

> anything remaining should belong to the Reserve Banks to be distributed by them to the member banks upon the basis of average reserve balances carried during the year.

Governor Young in a letter to a New York banker on April 5, 1930, made the following observations:

> In the Federal Reserve Board's Annual Report to Congress, which will be issued very shortly, the Board will advise the Congress that they believe the time has arrived when the member banks should participate to a greater extent in the profits of Reserve Bank, but that the Board has no definite plan to suggest at the moment. Many suggestions have been made, but as we have analyzed them, we believed them to be faulty. We do believe, however, that an equitable plan can be arrived at and we are working to that end. I am convinced that the Board will never recommend the compulsory payment of interest on reserve balances, and I personally, at the moment, lean very decidedly towards the suggestion contained in the last sentence of your letter, which suggests that a portion of the earnings be distributed to member banks using both their stockholdings and reserves as a basis when and if earned.

Apparently no Board recommendations were ever made. In 1931 the Board indicated that it had refrained from making any recommendations in its 1930 annual report, pending "the conclusion of investigations now in progress by committees of Congress." [Letter dated April 1, 1931, to the Undersecretary of Treasury]

It should be noted that on at least two occasions, official correspondence of the Board has indicated that the Board does not have authority to pay interest on reserve balances. In a letter to Congressman James F. Byrnes, signed by the Vice Governor on January 15, 1924, the Board stated:

> There is nowhere in the Federal Reserve Act any provision authorizing Federal Reserve Banks to pay interest on the reserve deposits of member banks, and the Federal Reserve Board has no authority to require the

> Federal Reserve Banks to do so. All earnings in excess of the necessary expenses of a Federal Reserve Bank must be distributed in accordance with section 7 [of the Federal Reserve Act].[5]

Subsequently, in a letter to Mr. W. W. Philips on August 4, 1924, Governor Crissinger stated:

> there is no provision of the Federal Reserve Act which expressly or by necessary implication authorizes Federal Reserve Banks to pay interest on such deposits and because of this lack of express authority, it is believed that Federal Reserve Banks have no power under the law to make payments of this nature.

Statements made by various individual members of the Board more that 50 years ago are certainly not binding on the present Board. Moreover, those statements do indicate a more narrow reading of what we believe to be the System's implied authority to compensate member bans for reserves. As will be indicated in this memorandum, in light of the consequences of a continued decline in membership occasioned by the existence of the System reserve burden, such payments can be regarded as a necessary expense for a Federal Reserve System under section 7 of the Act.

Implied Authority and Necessary Expense

It is clear that Congress rejected the recommendation of those who believed that the Federal Reserve Act should

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[5] The original Federal Reserve Act provided in section 7 that all the net earnings of the Reserve Banks (less certain payments into a surplus fund) would be paid to the United States as a franchise tax. This tax was repealed by the Banking Act of 1933, which amended section 7 to provide for the payment of all net earnings of each Reserve Bank into that Reserve Bank's surplus fund. That Act also required the Reserve Banks to pay one-half of their surplus to purchase stock in the newly created FDIC and the action repealing the franchise tax was presumably taken in order to permit the Reserve Banks to rebuild their surplus. This provision of section 7 has not been further amended since 1933.

contain an express prohibition against the payment of interest on reserves. Moreover, we believe the reasons that might be shown as supporting the recognition of an implied prohibition to such payment have largely lost their validity over the passage of time. The most significant factual point is the elimination of the express prohibition against the payment of interest from the final draft of the Federal Reserve Act. That prohibition has appeared in many earlier bills, and we believe its omission from the final bill is not inadvertent. Senator Nelson pointed out explicitly that the Owen bill "is silent on that subject" [51 Cong. Rec. 451] and if a prohibition was later determined to be necessary, at least Senator Williams felt that "[t]hat would seem to fall within the powers of the reserve board" [51 Cong. Rec. 452]. Further, as was pointed out in the Senate Report, even though the System would not initially pay interest, "this may possibly be found expedient at some future time when the System is established" [Senate Report, Part 2, p. 12]. The Legal Division believes that it is reasonable to interpret this provision to mean that such authority would be left to the discretion of the Board and the Reserve Banks based on their express and incidental powers. We are of the opinion that such an interpretation is at least as reasonable as the view that such payment could be made only after specific Congressional approval, particularly in light of the extensive discussion and rejection of including an express prohibition in the Act.

Payment of Interest on Reserves as an Incidental Power

Section 4 of the Federal Reserve Act provides that Federal Banks are empowered:

> To exercise by its board of directors or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act. [12 U.S.C. 341]

This provision is virtually identical to the language of R.S. § 5136 (12 U.S.C. 24 ¶ Seventh), which similarly authorizes national banks to exercise all such incidental powers as shall be necessary to carry on the business of banking.

The House Report on the Glass bill (H.R. 7837) indicates that Federal Reserve Banks are to be assigned the function of "bankers' banks"[6] and that the powers of each Reserve Bank are to be "precisely analogous to those of national banks except insofar as altered by the act itself."[7] The courts also have regarded the incidental powers provision of the Federal Reserve Act to be virtually identical to the incidental powers provision of the National Bank Act.[8]

At the time of the passage of the Federal Reserve Act, national banks relied upon the incidental powers provision to pay interest on reserves of other banks since they did not possess express authority to pay interest on demand deposits. The payment of interest on reserves was, of course, a widespread practice at the time. Since national banks were authorized under the incidental powers provision to pay interest on reserves maintained with them by other banks, and since the incidental powers of Reserve Banks are regarded as virtually identical to those of national banks, we believe that Reserve Banks necessarily possess authority to pay interest on reserve balances under their incidental powers if such payment is viewed as "necessary" to carry on the business of banking as directed by the Federal Reserve Act.[9]

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[6] House Report, p. 16.

[7] *Id.*, p. 36. See also Senate Report, Part 2, p. 9.

[8] *Lucas* v. *Federal Reserve Bank of Richmond*, 59 F. 2d 617 (4th Cir. 1932); *Federal Reserve Bank of Richmond, Virginia* v. *Duffy, et al.* 210 N.C. 593 (1936).

[9] Member banks were subsequently prohibited from paying interest on demand deposits by the Banking Act of 1933 (12 U.S.C. 461). Such prohibition by its own terms does not apply to Reserve Banks.

While the Legal Division believes that it is appropriate for the Board to regard the payment of interest on reserves as essential to the continued strength of the System, it should be noted that in construing the scope of the incidental powers provision of the National Bank Act, courts have indicated that the term necessary does not mean "indispensable." At least two Federal circuit courts have stated the following:

> For an activity to be pursuant to an incidental power necessary to carry on the business of banking it must be convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers. [*Arnold Tours, Inc.* v. *Camp*, 472 F. 2d 427, 432 (1st Cir. 1972); *M&M Leasing Corp.* v. *Seattle First National Bank*, 563 F. 2d 1377, 1382 (9th Cir. 1977) cert. denied, ____ U.S. ____ (June 12, 1978)].

At the time the Federal Reserve Act was enacted, the Senate report indicated the expectation that Reserve Banks would not pay interest on reserve balances since member banks would receive benefits in the form of lower reserve requirements and access to the System's discount facilities and other services, such as check clearing [Senate Report, p. 12]. Today, however, member banks incur a very substantial burden that results from the need to satisfy System reserve requirements. In view of increasingly intense competition, many banks are regarding the burden of membership as outweighing the benefits derived from the System and are withdrawing as members. Over the past ten years, in fact, 551 banks have withdrawn, 69 alone in 1977. Because of the decline in membership, the proportion of total commercial bank deposits subject to reserve requirements has been reduced to about 72 per cent. The Federal Reserve has stated that continued erosion of membership threatens the soundness of the nation's financial system as more payments and credit transactions take place outside the Federal Reserve, as immediate access to the Federal Reserve's discount window is diminished, as

Federal bank supervisory and regulatory involvement becomes diluted and as implementation of monetary policy becomes more difficult.[10]

In view of the present situation, the Legal Division believes that it is reasonable for the Board to conclude that the payment of interest on reserves is a necessary expense in order for the Federal Reserve to accomplish successfully the basic purposes and objectives established by Congress and that Reserve Banks are therefore authorized to pay interest on reserves under the incidental powers provision of the Federal Reserve Act. Additionally, in light of longstanding judicial recognition that an agency's interpretation of statutes it administers is entitled to great deference,[11] we believe that it would be regarded as reasonable for the Board to determine that the payment of interest on reserves is a necessary action that is incidental to the functioning of the Reserve Banks as a means to assure the continued viability of the Federal Reserve System.

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[10] Statement by G. William Miller, Chairman, Board of Governors of the Federal Reserve System, and Philip E. Coldwell, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing and Urban Affairs, United States Senate, May 25, 1978, p. 6.

[11] *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, 568 F. 2d 549, 552 (7th Cir. 1978); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965).

(4)

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No. 05-1168

In the Supreme Court of the United States

TEXAS STATE BANK, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner possesses a cognizable property interest, giving rise to a takings claim under the Just Compensation Clause of the Fifth Amendment, in any portion of the net earnings of the Federal Reserve System.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-23a) is reported at 423 F.3d 1370. The opinion of the Court of Federal Claims (Pet. App. 24a-37a) is reported at 60 Fed. Cl. 815. An earlier opinion of the Court of Federal Claims (Pet. App. 38a-56a) is reported at 54 Fed. Cl. 352.

JURISDICTION

The judgment of the court of appeals was entered on September 21, 2005. A petition for rehearing was denied on December 13, 2005 (Pet. App. 57a). The petition for a writ of certiorari was filed on March 10, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Federal Reserve System, which includes the Federal Reserve Board of Governors and the 12 regional Federal Reserve Banks, monitors and influences the Nation's money supply "so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." 12 U.S.C. 225a. The Federal Reserve System is self-supporting and receives no appropriations from Congress for any purpose. See 12 U.S.C. 243-244; *Denkler* v. *United States*, 782 F.2d 1003, 1005 (Fed. Cir. 1986).

The Monetary Control Act of 1980 (1980 Act), Pub. L. No. 96-221, 94 Stat. 132, requires all depository institutions, including all banks, to maintain monetary reserves equal to a percentage of certain deposits they hold. 12 U.S.C. 461(c). Institutions may satisfy reserve requirements by holding cash in their vaults or by maintaining a balance in a non-interest-bearing account at a Federal Reserve Bank. *Ibid.*; see 12 C.F.R. 204.3(b)(1). Petitioner and its predecessors in interest have satisfied reserve requirements in one or both of those ways since the effective date of the 1980 Act. Pet. App. 5a, 40a.

At the direction of the Federal Open Market Committee, the Federal Reserve Banks implement monetary policy by buying and selling federal government securities. Pet. App. 3a. Those transactions are financed by, inter alia, funds deposited by depository institutions to meet reserve requirements. *Ibid.* The Federal Reserve Banks' open-market operations generate substantial income, see *id.* at 4a, a portion of which is used to pay operating expenses and dividends to member banks, as well as to fund the Reserve Banks' capital surplus accounts. The Reserve Banks' net excess earnings are

transferred to the Department of the Treasury. See *id.* at 5a. For fiscal years 1997, 1998, and 2000, transfers of portions of the Reserve Banks' surplus accounts were mandated by Acts of Congress. See *ibid.*

2. In October 2001, petitioner filed suit in the Court of Federal Claims (CFC). Petitioner "did not challenge the statutory requirement to maintain reserves pursuant to the Monetary Control Act, nor [did it] allege that such a requirement constituted a taking." Pet. App. 5a. Rather, petitioner alleged that it was the rightful owner of the income earned by the Federal Reserve System on petitioner's required reserves and vault cash, and that the United States had taken petitioner's property by directing that those earnings be transferred to the Treasury. *Id.* at 5a-6a. The government moved to dismiss the complaint for lack of jurisdiction, arguing that petitioner's suit was filed outside the applicable six-year limitations period (28 U.S.C. 2501), and that the case lay outside the CFC's jurisdiction under the Tucker Act (28 U.S.C. 1491) because the claims arose from a non-appropriated funds instrumentality (NAFI). In the alternative, the government moved to dismiss for failure to state a claim. Pet. App. 6a.

3. The CFC dismissed petitioner's suit for lack of jurisdiction. Pet. App. 24a-37a. The court relied on Federal Circuit precedents holding that "the Federal Reserve is not susceptible to suit in [the CFC] because it does not operate with appropriated funds." *Id.* at 29a. The court found that, "[a]t bottom," petitioner's suit "is directed against the activities of the Federal Reserve," notwithstanding the fact that the United States is the named defendant and the actions that are alleged to effect a taking were mandated by Acts of Congress. *Id.* at 31a.

4. The court of appeals affirmed on different grounds. Pet. App. 1a-23a.

a. The court of appeals held that petitioner's suit falls within the CFC's jurisdiction under the Tucker Act, notwithstanding the Federal Reserve Board's status as a NAFI. Pet. App. 8a-12a. The court acknowledged its prior holdings that "the NAFI doctrine precludes the exercise of Tucker Act jurisdiction over contract claims against the United States based upon the contracting activities of NAFIs that are not expressly mentioned in 28 U.S.C. § 1491(a)(1)." *Id.* at 9a. While suggesting that the NAFI doctrine is limited to contract suits, and that no jurisdictional bar exists to takings suits based on a NAFI's actions, the court ultimately declined to resolve that issue. See *id.* at 9a-10a. The court instead held that, because the Federal Reserve System's transfer of excess earnings to the Treasury was alleged to have been compelled by Congress and the Treasury, rather than undertaken by the Federal Reserve on its own initiative, petitioners' suit was properly brought against the United States. *Id.* at 10a-12a.

b. The court of appeals ruled in the government's favor on the merits, holding that petitioner had suffered no taking of property. Pet. App. 12a-18a. The court explained that petitioner "had no property interest, cognizable under the Fifth Amendment, in the earnings generated by the Federal Reserve through its investment of required reserves." *Id.* at 18a.

Petitioner relied on three decisions of this Court —*Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 162 (1980), *Phillips* v. *Washington Legal Found.*, 524 U.S. 156, 165 (1998), and *Brown* v. *Legal Found. of Wash.*, 538 U.S. 216, 233-234 (2003)—that recognize a general rule that the owner of the principal

deposited in an interest-bearing account possesses a property right to the accrued interest. See Pet. App. 14a. The court of appeals found those cases to be distinguishable, explaining that all of them "involved situations where third parties held plaintiffs' funds in separate interest-bearing accounts." *Ibid.* In the instant case, by contrast, petitioner "did not provide funds to a third party that were then deposited in an interest-bearing account in a private bank, but entered into a direct depositor relationship with the Federal Reserve." *Id.* at 15a. Under settled principles of banking law, the court explained, the effect of those deposits was to pass title to the money to the Federal Reserve. *Id.* at 15a-16a. For that reason, "even if the funds received by the Federal Reserve were used to earn interest, [petitioner] did not acquire a property interest in the earnings." *Id.* at 16a.

c. Judge Newman dissented in part. Pet. App. 19a-23a. Judge Newman agreed with the court of appeals majority that petitioner's suit was properly before the CFC. *Id.* at 19a. She would have remanded the case to the CFC, however, for adjudication of the merits of petitioner's claims. *Id.* at 19a-20a. She also disagreed with the merits of the majority's analysis of the takings claim, citing "[t]he rule that 'interest follows principal.'" *Id.* at 21a (quoting *Phillips*, 524 U.S. at 165); see *id.* at 20a-23a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of another court of appeals. Further review is not warranted.

1. A party that alleges a taking of property must establish that (i) it possessed an enforceable property right that was (ii) lawfully taken by the Government (iii) for public purposes (iv) without just compensation. See, *e.g.*, *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003, 1014-1015 (1992). Petitioner contends that, under 12 U.S.C. 464, funds that it deposits in a Federal Reserve Bank in satisfaction of reserve requirements "remain the property of the Petitioner and may be withdrawn by [it] at any time." Pet. 11; see Pet. 16 n.4. To the contrary, however, Section 464 merely entitles a Federal Reserve "member bank" (through which petitioner, a non-member, may make deposits on a "pass-through" basis, see 12 C.F.R. 204.3(i)) to make withdrawals from a reserve balance. Neither Section 464 nor any other provision of law gives a depository institution a continued ownership interest in funds deposited in a reserve account or renders a Reserve Bank a bailee of the deposited funds.

Rather, under ordinary principles of banking law, when a bank (including a Reserve Bank) "receives [money] and places the amount to the credit of a customer, the relation of creditor and debtor between them subsists." *Burton* v. *United States*, 196 U.S. 283, 302 (1905). The funds become the property of the bank, and the depositor obtains a claim against the bank for the amount deposited. See, *e.g.*, *United States* v. *BCCI Holdings (Luxembourg), S.A.*, 814 F. Supp. 106, 109 (D.D.C. 1993); *In re Kountze Bros.*, 103 F.2d 785, 789 (2d Cir.), cert. denied, 308 U.S. 586 (1939). Any earnings on funds deposited in Federal Reserve Banks therefore belong to the Reserve Banks, not to the institutions that made the deposits.

Petitioner contends that the reserve requirements in 12 U.S.C. 461(c) create a "special circumstance[]," in which "the normal bank debtor-creditor relationship" does not arise. Pet. 15 (quoting 5A *Michie on Banks and Banking*, ch. IX, § 1 (1994)). That argument is incorrect. Although petitioner is required to maintain reserves, it is not obligated to deposit them with a Reserve Bank; rather, it may instead hold cash reserves in its vault. See 12 C.F.R. 204.3(b)(1).[1] In any event, petitioner cites no statutory or contractual provision granting it any rights broader than those of a creditor of a Reserve Bank, and no authority for the contention that a requirement to hold funds in a particular way, or in a particular place, alters the legal relationship between a depositor and its bank. Indeed, the language in 12 U.S.C. 464 allowing a Federal Reserve member bank to withdraw funds from its reserve "balance" is more consistent with the existence of an ordinary debtor-creditor relationship.

2. Petitioner contends (Pet. 11-16) that the court of appeals' ruling conflicts with this Court's decisions in

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[1] That fact further demonstrates the invalidity of petitioner's claims. Petitioner was legally entitled to satisfy its reserve obligations by retaining possession of its reserves in the form of vault cash. Any decision to deposit reserves in a non-interest-bearing Federal Reserve Bank account therefore was a matter of choice (presumably for petitioner's convenience) rather than government compulsion, and hence cannot give rise to a compensable taking. See *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1006-1007 (1984). To be sure, petitioner would not have earned interest on its vault cash either, but a mere limitation on the use of private property does not give rise to a per se takings claim. *Tahoe-Sierra Pres. Council, Inc.* v. *Tahoe Reg'l Planning Agency*, 535 U.S. 302, 322-323 (2002).